

BUSINESS ECONOMICS

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PREFACE

THIS book is primarily intended to give young students of commerce a general survey of commercial institutions, and the human activities that have brought them into being and developed them to their present pitch of efficiency. It aims at helping the student of business science to grasp the fundamental principles of economic laws that govern the whole structure of trade and commerce. Great changes have taken place during the past hundred years, and the young student has some difficulty in understanding the working of the intricate machinery.

All authorities are agreed that no course of commercial education is complete that does not include business economics as the main subject of study. We have endeavoured to present the elements of the subject in as simple a form as is compatible with the nature of the enquiry. It remains for the teacher to bring home to the student the truths expounded by taking concrete examples from his daily experience.

In the study of business economics we are only concerned with general economic thought in so far as it influences action and tendencies in modern times. We have consequently discussed such a problem as rationalization, because the economic ideas underlying rationalization have led to action which is altering the size of the business unit, and is influencing the

relation of employers and workmen. But we have not mentioned new theories of the distribution of commodities and services which, if generally accepted, would alter the whole direction of present-day commerce, important as such discussions may appear to the student.

Our ideas of economic laws—indeed, of all scientific laws—have to be revised as new discoveries are made, or as social institutions such as slavery, or regulating guilds are swept away. The large profits earned by the modern entrepreneur would have been considered anti-social in mediæval times ; and in the continuous growth of society we must be prepared for the further limitation of free competition. The student of business economics should know something more of the history of the great institutions whose form and functions he is studying than is found in this book. He must also know much more about the documents and forms that are used to facilitate the working of the machine. Many manuals are available for this further study.

We are well aware of the inadequacy of our treatment of some of the subjects ; but we hope we have provided teachers in schools of commerce, technical institutes and secondary schools with a textbook which will help their students to assimilate economic truths and relate them to the facts of their daily experience.

The problems and exercises at the end of each chapter should help the student to apply the knowledge he has acquired.

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CHAPTER I

INTRODUCTION

The scope of the subject.—Business economics may be defined as that branch of economics which is directly or indirectly concerned with the exchange of commodities and services ; it is a study of the methods by which goods pass from the producer, or source of supply, to the consumer, or to the place where they are used to satisfy the wants of men. The study of business economics has therefore much in common with what was formerly known as “ the theory and practice of commerce ” ; but business economics is much wider in scope than commerce and is more closely related to general economics, for it aims at analysing and classifying the various forms of commercial activity to give the student a general idea of “ the structure and functions of commerce as a whole.”¹ As a consequence of this analysis and classification, the student is in a position to draw general conclusions which extend the application of his knowledge.

The study of the subject thus aims at increasing the “ general scientific commercial knowledge ”¹ of the student. In this book we have described the growth of business institutions in order to link up the present

¹ *Board of Education Memorandum*, No. 1116, 1919.

with the past, and help in the process of analysis ; and the mathematical measurement of facts forms an essential part of the analysis. The field of study is a wide one, as the relations of the various branches of commerce have to be examined in order to lay a sure foundation for more advanced studies in one or other of the specialized departments of the science.

Economics is the whole body of classified knowledge which considers the actions of man in the ordinary business of life—or what is called the production, distribution, and consumption of wealth ; and it is the object of business economics to relate these actions to the actual machinery, or organization, whereby trade, business, or commerce is pursued. Eminent economists have experienced difficulty in defining wealth, but for our purpose as business men the definition of Dr. J. N. Keynes, M.A., will serve : “ Wealth consists of all potentially exchangeable means of satisfying human needs.”

The great European War afforded opportunities of testing the accuracy of economic thought and proved that the foundations of the science had been well laid by the great thinkers of the past. The effects of inflation have been felt in most countries ; monetary theories have been studied more closely, and also the effects of government control of production and of prices. The problem of sound finance is pre-eminently the subject-matter of business economics.

The evolution of trade and industry.—In primitive societies, or groups of people, wants of an elemental kind are satisfied by hunting and fishing, and the

fashioning of clothing, shelters, and the implements of peace and war. The producer and consumer are usually embodied in the same person. *Trade* hardly existed until the hunter and fisherman had to go far afield for their supplies, and it was limited probably to the occasional exchange of a few articles of luxury, such as beads for skins—a process known as barter. In the *pastoral* stage man was more secure and could provide more easily for his wants and needs in the future by reason of possessing cattle. In the more advanced *agricultural* stage rendered possible by the use of cattle, when man had learned to labour and to save, little was needed that could not be obtained within the village. Some of the more skilled members had developed handicrafts, and could exchange their services as craftsmen for the commodities or the services of their neighbours. Money—in various forms—began to make exchanges of this kind easier, and from the growth of these agricultural communities, which lived by tilling the soil and the breeding of animals, sprang the wider relations of group with group. Even in the more advanced communities of mediaeval England the people generally satisfied their requirements with their own hands. There were in each village or community persons who by reason of special skill became the village carpenter, blacksmith, or clothier. Little was exchanged outside the group except a few luxuries such as salt, wax candles, tar and spices.¹

The student of European social history can study

¹ Cunningham, *Growth of English Industry and Commerce*, vol. 1, pp. 72, 130 (note), etc.

the development and decline of what is known as the *manorial system* of cultivating land, which lasted some hundreds of years (in England until the middle of the sixteenth century). Plagues and revolts of the peasants helped to sweep away this intricate system of human relationship. The service of the labourer was commuted for a money payment, and this change to the payment of money helped to give an impetus to industry and made imperative the need for an adequate supply of metallic currency.

Labourers and artisans tended to move to the larger villages, which grew into towns. The towns purchased charters of freedom from the lords of the manors, and the *domestic*, or *family system* of industry developed rapidly. Soon the professional craftsman appeared, who made the carrying on of his business his whole occupation. Naturally, the work was still on a small scale; it had to be done in the homes of the craftsmen, often with materials supplied by the customer for whom the articles were being made. When the number of craftsmen increased in the towns, they tended quite naturally to associate together in groups known as *gilds* for protection and the control of their industry.

Up to 1700 this was the general condition of production in Europe; but the markets were continually widening, and intermediaries became necessary between the maker of articles and the person who needed them for his use. The woollen industry in England in the eighteenth century shook itself free from the gild system, and moved to centres where supplies of wool were available in close proximity to water for washing

the wool. With this movement appears the merchant-clothier who supplied wool for the makers of the cloth, and gradually controlled their work. When the worker began to be taken from his own home into a building provided by the merchant-employer, the *factory system* emerged, and with it the beginning of the modern system of production. With the application of mechanical inventions towards the middle of the eighteenth century to the arts of spinning and weaving, the industrial life of England was revolutionized. Then came the use of the steam engine to provide power at any point where power was needed, and commodities could henceforward be manufactured more easily, more rapidly, and at a fraction of their former cost. The growth of the factory industry and the massing of people in industrial centres is known as the *Industrial Revolution*. The industrial revolution is still proceeding.¹

Arising out of this era of mass production and the standardization of the products of industry, are certain powerful economic problems which are fundamental to the study of our economic system.

1. *The Capitalistic System*.—To be a manufacturer in the days prior to 1750 necessitated the personal acquirement of skill in a craft. Almost any person with the requisite skill could purchase the small quantity of raw material that was required to make a finished

¹ "We are passing through a period of industrial revolution which may be likened to that which followed the Napoleonic wars, for the vast changes made in the system of modern production, in the new uses of old materials, and in the discovery of new materials, are as revolutionary as the introduction of machinery itself." *Times : Financial and Commercial Review*, 1929.

product. With the growth of factories, something more was required than knowledge of a craft and a small amount of raw materials. A building had to be erected, plant and machinery had to be installed, wages paid to workers, and large quantities of raw materials bought for the workers in the factory to use. The buildings, raw materials, machinery, plant, etc., are known as *capital*, and those people who could not readily obtain command of this capital, no matter how skilled they were, were forced to work for others for wages. Hence arose the modern system of wage labour. On the one side are the people who control the equipment necessary for industrial production, and on the other side the mass of people who have nothing beyond their skill, and therefore have to work for wages.

2. *Value and the Mechanism of Exchange*.—In the simple village community the artisan makes and sells his article to his neighbour, and in return obtains some necessary article of food, clothing, or shelter. The area within which the exchange of commodities takes place is necessarily small. Communities still exist to-day in which men directly exchange goods for goods. The measurement of the value of the goods exchanged is arrived at in a rough and ready way by the consideration of the different wants of people for food, furniture, clothing, or shelter. With the advent of mass production, and the dividing up of occupations into thousands of different categories, the amount of exchanging that has to take place to satisfy our most simple needs is enormous. If ten persons, with their own hands, make all the parts of a watch, they end by having one watch

each. If each of these persons specialized in making parts of watches only, many exchanges of parts would have to be made before each had a complete watch. But this process of specialization has been going on at an ever-increasing rate all over the world for the last 150 years, with the result that the exchange of articles becomes more and more complicated. *Value* has become a problem not merely of national but of international measurement, and money, credit, and banking systems help to make the exchange of goods and services easier. It was necessary, even in remote antiquity, to adopt a commodity which would be accepted by everyone in exchange for any other commodity, and which could also be used to measure the value of any other commodity.¹

3. *The Growth of Markets*.—The use of some substance, or commodity, that was readily acceptable by everyone made exchange easy, and led to the growth of small merchants. Even in the early Middle Ages, when a self-sufficing economy was prevalent, wandering pedlars passed through the villages and towns selling foreign wares, and local fairs or markets began to be organized. Then came national and international fairs, and the development of the work of the retail merchant who took goods from the local producer, the miller, or maltster, and sold these goods to the public.

The retail "shop" has undergone an extraordinary transformation in the course of the past century into the modern "store"—a market in which the products of all parts of the world are displayed for sale in

¹ See definition of money, p. 81.

palatial buildings. The producer of these goods is far removed from the person who takes them home to use them. With the increased facilities for the transport of goods by land, sea, and air, the producer, generally speaking, has the whole world as a market for his wares. He makes, or grows, goods for thousands of people he will never see ; and he often finds it to his advantage to sell his commodities to someone who in turn sells them to the shopkeepers or manufacturers. Here emerges what is called the *wholesaler*, who does not himself sell goods direct to the public. Again, where goods are sold abroad, the producer may prefer to sell his goods to an agent in the first place, and the agent in turn sells them to the wholesaler. Another link is thus forged in the chain which connects the producer and consumer. In all branches of commerce these intermediaries exist, with the result that the process of distribution appears to become more and more complicated. The reaction may be towards a simplification in view of the constant improvement of roads, rivers, railways, ocean steamers, aeroplanes, and wireless communications.

The student should attempt to visualize the varied channels through which raw materials and manufactured goods pass before they are ultimately in the hands of the man, or woman, who consumes them ; and the diagram on page 127 may help him to this end.

4. *The Growth in Size of the Business Unit.*—The great changes in market conditions referred to above have favoured the bigger businesses that are producing and marketing goods. Economies can more easily be

effected by larger businesses. Originally one person negotiated the sale of the wares he manufactured ; he was the *sole-trader* of commerce. Then sole-traders combined and formed *partnerships* and trading societies (regulated companies). In the course of time the necessity of getting more and more assistance in building larger factories and more expensive machinery presented itself ; in other words there arose a demand for more capital, and new forms of business undertakings known as companies grew up, to which persons lent their money in return for a yearly rate of interest. In order that the lenders of this money should not be ruined if the company failed to achieve its object, legal means were found for limiting the liability of lenders, or investors. When the law was passed in England in 1862 to limit the liability of shareholders, people were encouraged to save and invest their money without fear of losing more than the amount they had invested.

The result of this legal protection was that industrial progress was stimulated ; companies became larger and larger, until to-day they have become national and international in character. The student should contrast the hundreds of small banking establishments of 1820 with the five great banks of to-day, or the number of railway companies operating in restricted areas in 1850 with the four great railway companies in England now. Factories, "stores," railways, banks tend to become larger in the course of time¹ ; new

¹ " Leading companies engaged in the iron, coal, steel, electrical, and engineering industries have taken important steps towards

Acts of Parliament have to be passed to prevent these giant organizations from unduly limiting the liberty of the public. The tendency is for these great companies to obtain complete control of supplies of commodities such as oil, rubber, sewing thread, or tobacco, and to fix the price at which these things shall be sold to the public.

5. *International Trade*.—International trade has existed from very early times; but the prosperous commercial intercourse of the early races of the Mediterranean cannot be compared with the world trade of to-day. Science and invention have penetrated to hitherto unknown parts of the world; people have everywhere been trained to desire and use the manufactured articles of modern industry.¹ Time and distance are eliminated gradually with modern methods of transport. Goods can be conveyed from Europe to Australia with greater facility to-day than they could be sent from London to Manchester in 1815. The interiors of continents have been opened up by roads, railways, and aeroplane services. Science and education everywhere help in improving the facilities for the exchange of wealth. Raw materials are distributed throughout the world, and international trade

reorganizing and readapting their businesses to meet the radical change which has taken place in these universal industries since the war." *Times : Financial and Commercial Review*, 1929.

¹ "To-day the industrialists are bending their efforts towards forcing the natural tendency to change. . . . Nearly a thousand industrial organizations are maintaining separate research facilities in addition to which there are more than 70 trade organizations and 150 colleges and technical schools engaged in research." *Forum Magazine* (U.S.A.), April, 1929.

becomes the concern of all nations. Problems of exchange therefore become more significant ; standards of living in one country affect the wages of workers in other countries the world over. These are a few of the questions we have to consider when we are discussing foreign trade.

6. *The Direction of Human Activities.*—It will readily be seen that with the growth of large-scale business, the problem of organization becomes more difficult. The process we have reviewed shows a continuous growth ; one development proceeds from another ; changes take place in habits and customs of nations ; knowledge becomes greater ; and all are concerned with everything that disturbs the working of the vast machine, and its control.

The expansion of the business unit and the growing difficulties of organization call for :—

- (i) More highly trained minds ;
- (ii) The co-operation of all classes in the full exploitation of world resources , and
- (iii) An intelligent industrial democracy from among whom the controllers of industry can be recruited.

PROBLEMS AND EXERCISES

1. Why does a young man in modern business need to know something more than his immediate job ? Why does a football player need to know the work that is expected of the forwards and half-backs as well as the game he is called upon to play as " back " ?

2. How can the playing of a team-game be compared with working in business? Does the modern sportsman specialize? Why?

3. Would a young man who knew something of the "structure and functions of commerce as a whole" be more likely to succeed in some line of business? Why?

4. Trace the evolution of trade and industry from early times to A.D. 1700.

5. How does the economic organization of to-day differ from that of the Middle Ages?

6. Why are the changes in the economic organization which took place in the middle of the eighteenth century referred to as "The Industrial Revolution"?

7. Contrast the characteristics of the modern capitalistic system of production and distribution with those of the *domestic system*.

8. Why was the invention of printing with movable type important economically? How has printing aided economic evolution?

9. Why does an economic organization exist at all? If no organization existed, what would each of us have to do to satisfy his wants? Are wants more easily satisfied to-day than formerly?

10. Contrast the organization of commerce and industry under the guild system with that of to-day. Distinguish clearly the main characteristics of the two systems, and their influence on problems of labour and capital.

11. How do you account for the difference in the rate of growth of towns in mediaeval England and in America during the last thirty years?

12. How far are we correct in saying that the guild workers were capitalists as well as labourers?

13. Contrast the problems that the manager of a modern manufacturing business has to face with those of the old master-craftsman under the headings of (a) finance, (b) marketing, (c) risk-bearing, (d) obtaining workers, etc.

14. Why was it possible for a "just price" for the sale of goods to be fixed in mediaeval times, and not possible to-day? What work done by the guilds is now done by the government?

15. Discuss the educational functions of the guilds. How

did they prepare young people for business? How is this work of preparation done to-day, and why? Does it make any difference to the community nowadays whether men are well trained for business or not?

16. Why did the movement of labourers into towns on the breakdown of the manorial system tend to extend the use of money, the growth of competitive business, a wage system, and specialization in production?

17. Compare life in the agricultural villages of India, Japan, or Egypt to-day with that in the manorial village of England in the Middle Ages.

18. "The whole purpose of our economic organization is the gratification of our wants." What part do laws, railways, roads, workshops, and factories play in this process?

19. Try to trace the journey of, say, Californian plums or Argentine chilled meat, from the sources of supply to the shops in your town or village. What persons do you think have been most interested in the passage of the goods from the producer to your town store?

20. How far is it true to say that "the producer has the whole world as a market for his wares?" Of what produce would you say that this was not true? Why?

21. Is it true that "standards of living in one country affect the wages of workers in other countries?" What work is being done by the League of Nations to prevent the underpayment of labour in some industries abroad?

FURTHER READINGS AND REFERENCES

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- Clay, H. *Economics for the General Reader*, chap. i and ii.
- Hammond. *Rise of Modern Industry*, part ii, pp. 66 to 178.
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CHAPTER II

CAPITAL

ITS FORMS AND FUNCTIONS

The Meaning of Capital.—In a primitive society a man makes everything he requires with his own hands. In order to satisfy his requirements for, say, domestic furniture, he must obtain some timber, and must possess some implements with which to fashion out of this timber a chair, a table, or a cupboard. To obtain what he requires three things are necessary :—

- (i) The application of his own labour and skill.
- (ii) The possession of some kind of material, in this instance, timber, and
- (iii) A store of food to keep him while he is working up the timber into furniture.

In the things mentioned in No. (ii) and No. (iii) above, we see the beginnings of capital¹: *the material equipment with which a man is able to make commodities that satisfy his wants*. If this man gave a friend part of his store of food to help him with the work of making furniture, the friend would be said to be consuming part of his capital. It will be readily seen that to satisfy even such elemental wants *some*

¹ Cunningham, *Growth of English Industry and Commerce*, vol. i, p. 4.

capital is necessary in order to keep the man during the time he is working to satisfy his want for furniture. The saving of supplies of foodstuffs to enable a man to get a greater satisfaction in the future is the very essence of what we mean by capital. Everything that is used to assist in producing something else, and not consumed for its own sake, is capital in the economic sense: raw materials, tools and instruments, stores of food.

With the discovery of the power of steam and its application to industry, with the growth of inventions, with the education of the people, and the consequent increase in the variety of goods demanded, it becomes necessary to possess considerable capital in the form of buildings, machinery, raw materials, etc., to work up the raw materials into finished goods. Hence from 1750 onwards, when industries began to be carried on more and more in factories and large workshops, the possession of capital—or of the money which can buy the things necessary for production—became vitally important to the person who intended to manufacture on his own. The smaller worker, who could not get control of the necessary capital, and who could not consequently erect buildings and put machinery in them, was compelled to work for another for a payment, or wage. By the beginning of the nineteenth century the modern wage system was firmly established in industry, and the possession of capital gave a person the power to command labour and to produce goods.

Mass production, the “modern method by which great quantities of a single standardized commodity

are manufactured", and the enormous increase in variety of goods, have brought about the need for larger and larger supplies of capital. Visualize the capital that would be required to-day by any person who desired to set up a factory for the making of motor-cars, or the making of iron and steel goods. Large buildings, elaborately fitted with expensive machinery; tons of material of all kinds: iron, steel, zinc, timber, textiles; sidings, and trucks linking the works with the railway; large lorries for transporting the finished goods; thousands of pounds sterling for advertising the goods before they were made—these are only a few of the capital requirements of such a business enterprise on a large scale to-day.

The wage earner thus appears to become more and more widely separated from the person who controls the capital necessary to produce the apparently limitless wants of mankind. This separation of the wage earner from the capitalist has led to one of the greatest problems of modern times. With the growth of industries in size and complexity; with the increase of capital in each individual concern; with the growth of enterprises of international importance; there seems to be less opportunity for the skilled worker without capital to become his own master.

England was fortunate in being able to accumulate capital rapidly during the eighteenth century, largely through her participation in the Colonial and Indian trade. Spices, sugar and tobacco were sold in large quantities, and with the growth of banking and her secure political position she was in a position to take

full advantage of the mechanical inventions which ushered in the industrial revolution.¹

The growing population of Great Britain demanded increasing supplies of food and raw materials, and England's industrial system became a model for the world. British investments and British machinery were mainly responsible for the rapidity of the change and British skill guided the efforts of pioneers in North and South America.²

It is now generally appreciated by all classes that labour is not the only requisite in production.³ The use of capital on a large scale has enabled more commodities to be produced at a smaller cost, and in less time than formerly. Briefly, the whole community is indebted to the growth of capital for the material necessities, conveniences and luxuries which we enjoy to-day. Modern thought is not so much concerned with the usefulness of capital—its usefulness is now undisputed—but with its ownership. Few people would deny the truth that the more capital a community possesses, the greater will be its power of production and its capacity to grow more wealthy.

The different forms of Capital.—When we speak of

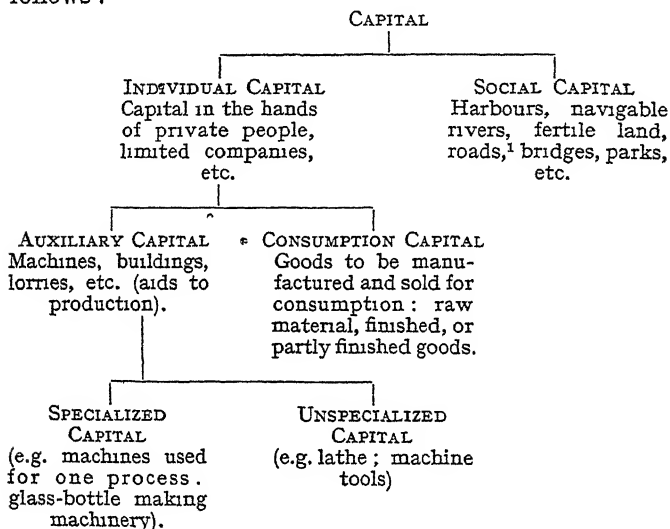
¹ Knowles, *Industrial and Commercial Revolutions*, p. 34.

² The enormous growth in the value of capital during the last century will be realized by comparing the estimated value of the total capital stock of the United Kingdom at the beginning and end of the century:—

| | | |
|------|-----------------------|-----------------|
| 1800 | (Colquhoun's figures) | £2,700,000,000 |
| 1910 | (L. G. Chiozza-Money) | £13,762,000,000 |

³ Capital may, however, be regarded as the result of labour in the past. The seed saved from this year's harvest, the factory building, the machine and plant, were all produced by labour.

capital we usually express our thoughts in terms of money, though by money we mean the things money buys for a special purpose, to be used for increasing production. Capital by itself does not produce more capital, or greater wealth. It has to be used by men, who are guided in their work by an organizer. The various kinds of capital have been classified as follows :—



Individual capital can be further subdivided into Fixed and Circulating capital.² A glance at the capital of any manufacturing concern will show that part of

¹ Sir Henry Maybury estimated the replacement value of the roads of Great Britain, in May, 1929, at £2,000,000,000.

² Adam Smith, *Wealth of Nations* (Ward Lock's reprint), pp. 220-6.

the capital is represented by equipment of a fixed nature, i.e. the equipment is used over and over again year after year in the manufacture of the goods the company sells to its customers. Buildings, machines, and the plant and fixtures would come under this heading. Contrasted with this is the circulating capital consisting of the stock of raw materials, timber, metals, etc., that is consumed, or used up, in the manufacturing process and sold as finished, or partly finished articles. This circulating capital in other words does not retain its form from year to year, but is continually changing its form: it is continually circulating. Ultimately, of course, even fixed capital becomes used up. We call the process of using up, "wear and tear." The difference between fixed and circulating capital is partly the question of the purpose for which each is used, and partly the difference in the time which elapses between the consumption of each kind.

Interest.—Interest is the remuneration paid to owners of capital for the privilege of using it. In the past the justification of interest has been doubted, and even to-day it is felt by many that receivers of interest—owners of capital—are receiving something from the community for which they have contributed nothing in return.¹

It must be realized, however, that capital is borrowed because it is of some use in increasing the production of goods. Without buildings, machinery, and lorries,

¹ Cunningham, *Growth of English Industry and Commerce*, vol. i, p. 366.

etc., the quantity of goods turned out from factories would be much smaller than it is. Hence there is a demand for capital because of its usefulness, and as long as private ownership exists, people will be able to make a charge for lending the capital they possess. The greater the demand on the part of people who want capital for productive purposes, the greater will be the price that the owners of capital will charge.

The rate of interest at any period is consequently determined by :—

- (a) All those forces which affect the supply of capital on the one hand ; and
- (b) Those forces which affect the demand for capital on the other.

FORCES WHICH AFFECT THE DEMAND FOR CAPITAL

Increase of population.—During the last century the population of England alone increased from 12 to 36 million. Each member of a growing population has wants and demands for food, clothing, shelter, etc. These wants give rise to a demand for capital to provide factories, etc.

Inventions.—The spread of education and knowledge goes hand in hand with an increase of population. New ideas emerge, new methods of manufacturing are brought about ; new uses are found for products that were formerly discarded ; with the result that the variety of goods which people want and demand is considerably increased. More houses for the workers, more transport facilities, more means of recreation for all classes, create a demand for capital.

High average level of ability.—The energy and skill with which workers use raw materials is a further factor in creating a demand for more capital in a community.

FORCES AFFECTING THE SUPPLY OF CAPITAL

1. *Increased facilities for saving.*—The capital created by the primitive savage in the form of a stock of food, rough articles of clothing, and furniture, is the result of foresight in not consuming the whole of his wealth. A store of wealth is created for use in the future: it is saved. Similarly all capital to-day is the result of saving carried out by generations of people in the past. The growth of capital is thus controlled by the amount of saving, but not entirely by the mere difference in what is produced by a community and what is consumed to satisfy immediate wants. Banks and other organizations offer greater facilities for saving and for safe investment than existed in the past, and the feeling of greater security that the modern citizen of a civilized community enjoys is a powerful factor in saving. The fear of war, or revolution, tends to destroy the desire to save. Capital will only be accumulated under secure social and political conditions.

2. *Mass Production.*—The ease with which standard articles of commerce can be manufactured in large quantities also tends to increase the supply of capital.

3. *Education.*—Education in all countries has proved a stimulus to saving. The habit of saving is slow to

develop. With the increase of knowledge, men and women have learned to make provision for the future. Social competition between the different classes in a community has spurred people on to amass fortunes : to live for the future.

The result of these series of forces affecting the supply of and the demand for capital has been evidenced in the rate of interest which has been charged for capital during the last 300 years. There has been a gradual decline in the rate of interest from the reign of Henry VIII in England. In that reign the usual rate of interest was 10 per cent.¹ In the reign of William III (1688) the usual rate had fallen to 8 per cent. The average rate of interest for the last twenty years on what is known as gilt-edged securities is roughly 5 per cent.² As a result of the increase of capital owing to modern methods of production in America and elsewhere, and the progress of modern invention, the rate of interest on capital may fall still lower ultimately ; but it would be a mistake to prophesy because of the many factors that are involved.

¹ Palgrave, *Dictionary of Political Economy*, vol. ii, p. 432.

² " For the past five years (1924-8) average money and discount rates have been as follows :—

| | £ | s. | d. |
|------|---|----|-----|
| 1924 | 4 | 0 | 0 |
| 1925 | 4 | 11 | 6 |
| 1926 | 5 | 0 | 0 |
| 1927 | 4 | 13 | 0 |
| 1928 | 4 | 10 | 0." |

—*The Times*.

PROBLEMS AND EXERCISES

1. Mention the different forms that the capital of a retail trader might take.

2. Why should we keep up and improve (a) our land by the use of fertilizers, (b) workers by means of education, (c) our capital resources in the form of factories, tools, roads, etc. ?

3. Classify the following forms of capital live stock, farm implements, manufacturing machinery, railways, telegraph systems, ships, natural harbours, rivers, irrigation enterprises, privately owned water works, public electricity undertakings, imported merchandise, coal, furniture, motor cars, warehouses, and tools.

4. Why would the well-being of a pioneer depend on “ (i) his health, (ii) his physical strength, (iii) his intelligence, (iv) his judgment, (v) his ambition, (vi) his energy, (vii) his perseverance, and (viii) his imagination ? ” Are these qualities needed in the young business man to-day ? What advantages (if any) does the modern man possess over the pioneer ?

5. Would you call the spear of the Red Indian, the boomerang of the Australian aborigines, and the pit the trapper makes, forms of capital ? Why ?

6. “ Natural forces were used in industry prior to 1750.” Is this true ? Do we use natural forces to-day ?

7. How is science an aid to industry ? Give examples to show how science has assisted in providing us with various forms of capital.

8. Contrast the work of the farm labourer with a scythe and his work with a motor mowing machine. Why is his work with the latter tool more productive ?

9. Why has progress been more rapid since machines have been used to make machines ?

10. What causes would tend to retard the growth of capital in a community ?

11. What are the disadvantages of the extensive use of highly specialized machinery ?

12. What would be the immediate and ultimate economic effects of a rapid introduction of labour-saving devices in some of the leading industries of any country ?

13. Compare the use of the term "capital" in business economics and its use by accountants. Why is it sometimes useful to use the word "money" as if it meant "capital"?

14. Is it possible for the supply of capital to reach a point of satiation?

15. Distinguish between the capital employed by a company and the capital owned by the shareholders.

16. What conditions determine the rate of interest paid on different types of securities?

17. Why is it possible, in view of the powerful and expensive machines that have to be used, to produce a suit of clothes in a factory more cheaply than by hand? Discuss the matter as fully as you can.

18. Why are machines and patents such significant forms of capital to-day? Show how machinery pervades our economic life to-day.

19. Was the life of the worker on the manor regulated by the clock as our lives are to-day? Why must "summer time" be fixed by law? What would happen if workers arrived at the factory at different times?

20. Show how the machine dominates our working hours, our leisure hours, our amusements, and games, etc.

21. Is more or less effort needed to gratify our wants to-day than 800 years ago? Give reasons for your answer. When we think of the number of yards of cloth a worker in Lancashire can weave to-day, and compare this with the inches woven daily before the Industrial Revolution, what labour that assists the modern worker are we likely to overlook?

22. Why do you think the increase of productive power in the manufacturing industries has not been accompanied by a corresponding increase in the productive power of agriculture?

23. Compare the position of a business man in 1800 and to-day with reference to the facilities which are available to him in the establishment of a business as a sole trader.

FURTHER READINGS AND REFERENCES

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pp. 98-112.
- Taussig, F. W. *Principles of Economics*, vol. i, pp. 67-79
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- Cheyney. *Industrial and Social History of England*, chap. v-ix.
- Irving Fisher. *The Nature of Capital*.

CHAPTER III

CAPITAL IN RELATION TO MODERN BUSINESS

In the previous chapter an attempt was made to explain the meaning of capital, its different forms, and the forces affecting the supply of and the demand for capital. It is now proposed to consider the question of the methods of obtaining capital, and how capital is used in any modern commercial undertaking.

A distinction has already been drawn (on page 18) between the terms "money" and "capital". The money invested by a shareholder in a business gives him the right to own a portion of the capital. It is commonly stated that the capital of a company consists of, say, £20,000 in shares of £1 each; and from the point of view of the accountant the conception is a very convenient one. But what is really meant is that there is in the business material equipment which has a value of £20,000 which is owned by the owners of the shares—the legal ownership of the shares conferring the right to a certain part of the capital in certain circumstances, and to a share of the profits.

At the beginning of business activity, the nature of the undertaking will largely determine the ways in which capital will be obtained and used. If a person with relatively little capital wishes to establish a retail shop, he will probably contribute the capital out of his own personal savings and expend it on the purchase

of stock, fittings, and fixtures. He is technically known as the sole-trader, and is personally responsible for the control of his own capital. When businesses were small—as they were in England in the main until the beginning of the nineteenth century—and the demand for capital was limited, the sole-trader was the typical figure in business.

When the business demands more capital than the sole-trader is likely to be able to supply himself, one or more persons¹ may associate themselves together to supply and control the capital. The organization then becomes a *partnership*—the capital either being contributed jointly and equally by the partners, or in agreed proportions. The need for more and more capital in productive enterprise demanded a different form of association of owners of capital, whose liability was limited if disaster should befall the undertaking. In England in 1862 an Act of Parliament made the limited liability company possible ; and other countries have passed laws to limit the liability of the owners, in the event of the liquidation of the company, to the amount they invest.

The development of the large banks with branch offices in every town, large or small ; improved means of communication ; and better methods of publicity make it possible for business enterprises readily to secure the capital they need. In the capital market of England during the year 1928, £362,519,000² of

¹ No partnership may consist of more than 20 persons, or of more than 10 in the case of a bank.

² Midland Bank's figures.

new capital was raised to provide for new companies that were formed or reorganized. The scope of the business of many companies has become international, and it is necessary to give consideration to the methods by which the all-important business unit, the limited liability company, or joint-stock company, obtains its capital resources.

Capital is obtained from two sources: from people known to the promoter for private limited companies, and from the general public for the larger units. We need not consider the simpler methods of the private limited companies, but the student will understand that the public limited companies have to make use of the newspapers to bring schemes to the notice of the public, finance corporations, banks and insurance companies having surplus funds to invest, and many other agencies and institutions in order to obtain the vast sums required.

The capital is divided into shares and each subscriber offers to take a number of these shares, which can be of any denomination. The shares are given different names to distinguish the different categories: ordinary, preference, deferred, participating preference, cumulative preference. When there have been several issues of preference shares the words first, second, or third, may be used to distinguish one series from the other. The name of the share indicates the extent to which holders shall share in the profits of the company. The preference shareholder has a preferential right to dividend (distributed profit) over the ordinary, or deferred, shareholder. If the holder

of cumulative preference shares does not receive his promised reward in any one year, he is entitled to receive it in subsequent years: in other words the dividends become cumulative. If no dividend is declared in a particular year, the ordinary, or deferred, shareholders have no right to receive this lost dividend in subsequent years; they have suffered a dead loss for that year.

It follows naturally that owing to the different rights given by the holding of these shares they will vary in value according to the extent to which the holder has a claim to the profits of the company, or to prior payment in the event of the company ceasing business, i.e. going into liquidation.

The person who takes the initiative in starting a company or floating it to use the language of commerce, is known as the promoter. The successful promoter is generally an influential business man, who, although not necessarily possessed of a large capital himself, knows how to appeal to men and women with money to invest. He is not allowed to make a secret gain for his work of promotion. Supporting the promoter in the flotation of the company are perhaps three or four persons who have undertaken to make themselves responsible for the expenses connected with the preliminary negotiations. We have already hinted that it is sometimes costly to start a business enterprise. The people supporting the promoter will ultimately become directors of the undertaking.

To bring the objects and the possibilities of the proposed company before the notice of the public a

prospectus is drawn up, generally by a solicitor, or a chartered accountant. This prospectus is advertised in the daily papers. It shows the nature of the business of the proposed company, the capital required, the estimated profits, the officers controlling the policy of the company, etc., and asks the public to subscribe for shares. As a rule an application form is placed at the foot of the prospectus which may be filled in by the investor and sent to the company or the company's bankers with the necessary payment. It is customary to ask investors to pay a fraction only of the nominal value of the shares on application; if the shares advertised are £1 shares, then the investor is asked to send 2s. 6d. per share when he applies for them. For shares valued at £100, the buyer would thus have to pay in the first instance the sum of $100 \times 2s. 6d.$, or £12 10s.

After about a month, when the promoter and his friends have had time to discover the full extent of the public demand for shares, subscribers will be notified how many have been assigned to them: in other words the shares are allotted. At this time a further sum of 2s. 6d. per share will be due from the investor. The prospects of a company may appear so good that people flock to obtain the shares, with the result that the capital is over-subscribed. If such a company had asked the public to subscribe £100,000 in shares of £1 each, and had received applications for £200,000, the company would be unable to allot all the shares. As a company cannot issue to the public a greater number of shares than that advertised in

the prospectus, it may either issue the shares in the order in which they were applied for, or it may issue to each applicant a proportion only of the shares applied for. In the instance given above the company might decide to issue to each person half the number of shares applied for. The company would not return the application money sent in excess of the requirement, but would retain it and apply it towards the sums due from the shareholder after allotment.

In the course of time, on the date mentioned in the prospectus, a "call" would be made on the shares, and a further payment of, say, 5s. per share would have to be made to the company. Calls may be made in this way until the whole amount has been paid up. Some companies do not require shareholders to pay up the whole of the capital for which they have subscribed. The company mentioned above may require not more than £50,000 in order to begin its operations, and would consequently not call up the whole of its capital. The remaining £50,000 would be known as un-called capital, and it would act as a reserve which the company could fall back upon in case of need. If the reserve were readily obtained when required, the company would be in a strong financial position. The company would, of course, not have to pay interest on the un-called capital.

We would urge the student again to distinguish between the use of the term capital in the economic sense and the sense in which the accountant uses it. In the ordinary business use of the term, "called-up capital" is the money paid to the company by

shareholders, and this money entitles the shareholder to a certain portion of the capital of the company. The term is therefore ambiguous, and in a sense incorrect.

HOW THE MONEY RECEIVED FROM THE PUBLIC IS EXPENDED

The money received from the public is expended in buying equipment which is called capital. The kind of equipment bought will depend on the type of company which is floated, but broadly speaking it is correct to say that some part of the money will be spent in buying fixed equipment, or capital, and part in providing raw materials, such as timber and metals for the manufacturing company, and seeds and implements for the agriculturist, and in providing the wages of workers and the salaries of management. This second part is called *circulating capital*. The money which is sunk in the purchase of buildings and machinery is known as *fixed capital*.

Let us assume that a company has just been formed for the manufacture of a new type of vacuum cleaner, which has been patented by Mr. X. Let us further assume that the Company has a paid-up capital of £100,000, and that it has bought the patent rights from Mr. X. for the sum of £10,000. This will leave the company in possession of £90,000, which we will suppose is expended as follows:—

| | |
|-----------------------------------------------------------------|---------------------|
| Freehold Land and Buildings . . . | 20,000 [£] |
| Raw Materials: Metal, castings, ebony, brushes, etc. | 50,000 |
| Fittings and Furniture | 5,000 |
| Cash in hand and bank at | 15,000 |
| Patent Rights | 10,000 |

The patent rights, since they give the sole right to the company to manufacture the article, can be bought and sold, and form a part of the capital of the company.

In our imaginary company £85,000 has been expended in the purchase of capital, leaving £15,000 in the form of money which at any moment can be converted into capital, but which in actual practice would be retained in the form of money for the payment of wages to workers, or in the payment of expenses connected with the conduct of the business. For the first few months nothing may be received from the sale of the finished articles, and in the meantime the expenses mentioned above will have to be met.

Of the £85,000 worth of capital, £35,000 is sunk in equipment which is "fixed": it cannot be used to "maintain and remunerate labour", but is spent on equipment which is to be used over and over again in the making of the vacuum cleaners. Though this equipment gradually depreciates in value, it may remain very much the same for twenty years or more. What happens to the £50,000 worth of raw materials? Within a few months it is made up into finished vacuum cleaners which are being sold. The whole aim of the company will be to sell the finished goods at a cost

higher than the cost of making them (prime costs) and the additional costs (oncosts) incurred such as the salaries of management, rates, taxes, insurance, depreciation of fixed assets, and so on. Let us suppose that at the end of six months all the raw materials, which cost us £50,000, have been converted into vacuum cleaners and sold for £70,000 and that all the prime costs and oncosts amounted to £10,000. What has really happened? Our raw materials have been changed in form into finished goods and sold at a profit of £10,000.

The £70,000 obtained from the sale of the vacuum cleaners is called the "turnover" of the company for the six months. If it had taken us twelve months, instead of six, to sell all the cleaners, the turnover for the *whole* year would only have been £70,000. In the first instance £70,000 was turned over in six months, and if this rate of progress could have been maintained the profits would probably have been doubled during the year.

The student will realize that the time taken to turn over the goods with which we are dealing, or which we are manufacturing for sale, is an important factor in the making of profits. The more times our floating capital (or circulating capital) is turned over the greater will be our annual profits. In some enterprises the amount of capital that has to be sunk is enormous, as in the erection of blast furnaces, or large ocean-going liners, and if these fall into disuse for any reason grave economic results follow, because the money sunk is not available for other purposes. It must therefore

be our constant aim to adjust the proportion between sunk and floating capital.

What has happened to the £35,000 invested in fixed capital in our vacuum cleaner company? This has not been resold, or turned over, and therefore, in a sense it has not earned a profit for us. The greater the amount of our money invested in circulating capital, and the less invested in fixed capital, the greater our chance of making increased profits. Had our fixed assets swallowed up £15,000 only, instead of £35,000, there would have been a further £20,000 to spend on raw materials and labour to earn a higher profit.

A company that is compelled to spend a large amount of money on fixed capital, will not, as a rule, be able to make such large profits as a company in which the fixed capital is small and the floating capital large. The student has only to contrast the railway company with the modern store to see the truth of this general tendency. In a railway company before any profit can be made, thousands of pounds sterling must be sunk: invested in such fixed capital as the purchase of land, rails, stations, bridges, signalling apparatus, etc. It is estimated that as much as 80 per cent. of the capital of the company is sunk usually in fixed capital. It is not surprising, therefore, that the profits of railway companies expressed as a percentage of the total capital involved are small, whereas the modern store, in which the circulating capital is sometimes as much as 70 per cent. of the total capital, is able to earn a much higher profit.

The student should study the simple balance sheet of an actual manufacturing company, and proceed to the more complicated ones he will find in the daily papers. Remembering what we have already written on the subject, he will understand that the items shown on the Assets side represent the different items of capital or material equipment. The share capital shown under the heading of Liabilities represents the amounts originally received, and hence due to the shareholders—their capital rights.

J W GREEN & SONS, LTD

BALANCE SHEET, 31ST MAY, 1929

| <i>Liabilities</i> | | | <i>Assets.</i> | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------|---------|----------------------|---------------------------------------------------------|--------|----------------------|
| | £ | s d | | £ | s d |
| Share Capital authorized £100,000 in 9,000 Ordinary Shares of £10 each, and 10,000 8½% Cumulative Preference Shares of £1 each | | | Freehold Land and Factories (less depre- ciation) | 71,050 | 0 0 |
| Share Capital Re- ceived 8,201 Ordinary Shares, fully called up | £82,010 | | Fixed and Loose Plant, Furniture, etc | 17,500 | 0 0 |
| Less arrears of calls | 58 | | Goods in Stock | 28,274 | 12 1 |
| | | | Sundry Debtors | 22,101 | 13 1 |
| | | | Cash at Bankers and in hand | 8,722 | 12 6 |
| Preference Shares— 8,321 Shares of £1 each fully paid up | | 81,952 0 0 | | | |
| Mortgage on Property | | 8,321 0 0 | | | |
| Sundry Creditors | | 2,000 0 0 | | | |
| Reserve | | 18,202 3 6 | | | |
| Profit and Loss Account Balance at the credit thereof | | 25,000 0 0 | | | |
| | | 12,173 14 2 | | | |
| | | <u>£147,648 17 8</u> | | | <u>£147,648 17 8</u> |

THE PURCHASE AND SALE OF CAPITAL RIGHTS

It should be realized that a share in a limited company merely represents the "right" to own a certain part of its capital and participate in the profits. The share, therefore, derives value from the capital

which it represents, and the earning capacity of this capital. Shares, or capital rights, can be bought and sold, and facilities for transferring shares have increased with the growth of joint-stock enterprises. The facility for purchase and sale is often termed “mobility of capital”, though it must be understood that the capital itself is not mobile, but that the ownership of capital, as represented by pieces of paper, is mobile, or easily transferred.

The fact that capital rights can be transferred from one to another so easily enables the price of shares to act as a ready indicator of the success or anticipated progress of a company. The investor is able quickly to respond to changing conditions by selling his capital rights in one concern and investing the proceeds in another.

Stock.—Up till now we have discussed one form of capital rights only—the share—which entitles the owner to a certain portion of the capital of a company. Although the capital of a company is always divided into shares, fully paid up shares may, if the company's constitution allows, be changed into an equal amount of stock. Instead of speaking of £100,000 worth of shares of £1 each, the capital of the company would be described as consisting of £100,000 worth of stock. The main difference from the point of view of the investor is that fractional parts of stock may be purchased or sold.

If a limited company requires further fixed or circulating capital, it can either publish a new issue of shares, or can borrow money on the security of the

assets of the company ; it can pledge its assets by issuing what are called *debentures*. A debenture is a document, or bond, by which the company agrees to borrow a certain sum of money on loan for a fixed or indefinite period, at a given rate of interest. This loan may be secured by a mortgage on part or all of the company's property. The company may also undertake to pay back the loan within a particular period, when the debenture is said to be redeemable. Debentures, therefore, afford the lender a fixed return for the loan of his capital, and security for his investment. The debenture holder does not generally participate in the increased prosperity of the undertaking as the ordinary shareholder does, but he does not take the same risks of losing his money.

The student should familiarize himself with other forms of capital rights, such as gold bonds, Treasury bonds, government stock, bearer securities, etc. If he has understood the working of the economic system as already described, he will recognize that they are all similar, in that they represent capital rights. A glance at the financial columns of a newspaper will show how capital rights are classified into categories for the convenience of people with money to invest or lend.

Why a Person is Willing to Loan Capital.—A man may be quite willing to put his £100 into an enterprise because he has no immediate need of it. But some contingency may arise which will make it necessary for him to have recourse to his money. No business enterprise could be undertaken if it were possible for

the participants suddenly to demand their money back again.* The need of some mechanism by means of which he can transfer his ownership to another person for money is clearly manifest. The person giving the money will take over all the rights and privileges of the original investor. The market where stocks, shares, government stocks, bonds, etc.—securities as they are called—may be bought and sold is known as the *Stock Exchange*. On the Stock Exchange with the assistance of men called brokers and jobbers, a man can get rid of his interest in practically any loan or enterprise. A detailed description of the working of the stock exchange would be out of place in this elementary treatise, and the student is referred to the bibliography for a more serious study of this organization. The Stock Exchange performs the following economic functions:—

1. It facilitates the transfer of capital.
2. It advertises new companies.
3. It acts as a machine for measuring the relative values of different forms of business activity.

The joint-stock banks and brokers outside the Stock Exchange also assist in transferring shares for the public.

Influences affecting the Prices of Securities.—A few of the simpler causes affecting the price of stocks and shares should now be mentioned, but the student should study the chapter of *Value* (Chapter VI) before attempting to grasp all the underlying factors. The value of the piece of paper, called a share certificate, will ultimately be determined by a large number of

forces affecting the supply of the commodity which the certificate represents, and the forces affecting the demand for that commodity.

Coming back to our imaginary vacuum cleaner company (Chapter III, p. 32) we see that the value of the shares in this company would depend on the supply of vacuum cleaners as a whole, and the demand for them. If we analyse the forces of supply and demand, we find that supply will depend on the following influences among others :—

1. The nature of the vacuum cleaner, and the facility with which it can be manufactured.
2. The extent to which the skilled labour can be obtained to manufacture the article.
3. The facilities with which the raw material can be obtained and manufactured.

The demand for this particular cleaner will be affected by :—

1. The comparative advantages of other automatic cleaners already on the market.
2. The extent to which human labour for cleaning purposes can be obtained. A sudden influx of unskilled women into domestic service might induce people to dispense with a vacuum cleaner.
3. Other inventions which tend to eliminate dirt and dust.
4. The general standard of living of people in a country—a sudden wave of prosperity among the middle classes might cause an increased demand.

The few causes enumerated above will show how difficult it is to trace, or forecast, the causes affecting the price movements of the enormous number of commodities of modern commerce which are represented

by stocks and shares. General economic or political conditions in different countries, geographical influences, new inventions and discoveries, changes of fashion and in the mode of living—all exert powerful influences affecting almost the whole range of stocks and shares. Psychological causes, such as the fact that men are affected by the opinion of their fellows, add to the difficulty of correctly forecasting possible rises or falls in price levels of particular securities. The mere publication of an imaginary secret treaty between two states may be enough to depress all prices at one time. Sometimes a rumour of a fall in prices is sufficient to affect Stock Exchange movements of price, though there be no economic justification for the fall.¹

Quotation of Capital Rights.—The Stock Exchange is, as we have already said, a highly efficient market for the buying and selling of all kinds of securities. But before a security is placed on the "official list", the Stock Exchange has to be supplied with the fullest possible particulars concerning the origin, property, and activity of the company which the stock may represent. The man who wishes to buy or sell the stocks or shares may approach a stockbroker on the exchange, and give him the necessary instructions. The stockbroker will apply to a jobber on the exchange who will quote him two prices: one at which he is prepared to buy

¹ "The general nervousness caused by the present situation [in Germany] was reflected in a widespread and, in some cases, heavy fall in values on the Paris Bourse to-day."—*Times*, April 26, 1929.

the stock and the other at which he is prepared to sell it. The "jobber's turn" represents his profit on the deal. The stockbroker usually makes a standard charge to the public for his services as a dealer.

The quotations of the jobber, in securities which are in great demand, may be very close; the "turn" may be one-eighth only. An abnormal turn would show that the security was not in demand. Each day the committee of the Stock Exchange authorizes the issue of an official record of the prices of the different securities. This list of prices is of great value to intending investors or sellers.

The following extracts from *The Times* should be examined by the student, and newspapers should be brought into the class-room in order that the terms used in the official record of dealings may be discussed.

"Markets generally were cheerful in tone without showing much general activity. Favourable railway traffic returns gave a mild stimulus to Railway stocks and Coal, Iron and Steel shares. American advices were responsible for a rise in Associated Electrical and in a number of industrials in which New York is interested. . . . A further recovery in the price of rubber¹ had a stimulating effect on Rubber shares, particularly those of the Java companies. . . . The INDUSTRIAL market remained quiet, but there were several conspicuous movements, including a rise and fall in Imperial Continental Gas stock, and rises in margarine shares and motor shares. . . . There was a good demand for BANK shares, which showed a number of fractional rises. . . . The SOUTH AFRICAN market was idle, and, apart from a further fall, to $1\frac{2}{3}\frac{7}{8}$ in Sub Nigel, prices showed no important changes. . . . Broken Hill shares were easier."

¹ The interaction of markets is shown here.

OFFICIAL RECORD OF DEALINGS

"In the following statement are shown the prices at which business in officially quoted stocks was transacted yesterday as shown in the list issued by the Stock Exchange. Appended to each section will be found prices at which business was done in securities which, under the order of the Stock Exchange Committee, are included in the Supplementary List of unquoted securities. The sequence of marking is not necessarily that in which the bargains were done."

Various signs are used to show exceptional bargains, bargains done with or between non-members, or during unofficial hours, or whether the purchaser pays income tax.

BRITISH FUNDS

- "2½% Consols. $54\frac{9}{16}, \frac{1}{16}, \frac{7}{8}, \frac{5}{8}, \frac{1}{16}, \frac{3}{16}, \frac{3}{4}$, etc."
 "4% Consolidated Loan. $86\frac{1}{4}, \frac{1}{8}, \frac{1}{16}, \frac{1}{8}, \frac{3}{16}$, etc."
 "5% War Loan. $100\frac{1}{8}, \frac{7}{8}, \frac{3}{16}, \frac{1}{16}, 100\frac{3}{16}$, etc."
 "Bank of England. $250\frac{3}{4}, 1, 49\frac{1}{2}, 50$."

CORPORATION AND COUNTY STOCKS

- "Metropolitan, 3%. $83\frac{1}{4}, \frac{1}{2}$."
 "London County, 2½%. $53\frac{1}{4}$. 5% $103, 2\frac{3}{4}$."
 "Ditto, 6%. Bonds for Housing, 1930-31. $100\frac{3}{4}, \frac{5}{8}$."
 "Birmingham, 6%. $106\frac{1}{4}, \frac{1}{2}$."

DOMINION, PROVINCIAL, AND COLONIAL GOVERNMENT SECURITIES.

- "Australia, 6%. $101\frac{1}{2}, \frac{3}{8}, \frac{1}{4}, \frac{5}{8}$."
 "Newfoundland, 5%. $102\frac{1}{4}$."
 "South Africa, 6%. $100\frac{7}{8}, 101\frac{1}{16}$."
 "Canada, 3%. $86\frac{1}{4}, \frac{5}{8}, \frac{9}{16}$."

FOREIGN STOCKS, BONDS, ETC.

- "Argentine, $4\frac{1}{2}$ % Bonds, 1888-9. $95\frac{3}{4}, 96$."
 "Egyptian Pref., 5% in 1890. $69\frac{1}{2}, 69\frac{1}{2}$."
 "German, 7% Bds., 1924. $103\frac{7}{8}, 4\frac{1}{4}, 3\frac{1}{2}, 4\frac{1}{8}, 3\frac{3}{4}$."

RAILWAYS—GREAT BRITAIN AND NORTHERN IRELAND.

"Great Western, Cons. $85\frac{1}{4}$, 5, $\frac{1}{4}$, $4\frac{3}{4}$, $5\frac{3}{8}$, $\frac{3}{16}$, $\frac{9}{16}$, 5, etc."

"L.M.S. $52\frac{1}{4}$, $\frac{5}{8}$, $\frac{3}{8}$, $\frac{1}{2}$, 3, $2\frac{1}{2}$, etc."

"Southern Prefd. $74\frac{1}{4}$, 74"

"Met. Dist. $76\frac{3}{4}$, 7, 7, 6."

COMMERCIAL, INDUSTRIAL, ETC.

"Aerated Bread. 26/-, -/3, $-/1\frac{1}{2}$, 5/9, $-/7\frac{1}{2}$, $6/1\frac{1}{2}$, 6/-."

"British American Tobacco. $6\frac{7}{16}$, $\frac{1}{2}$, $\frac{3}{8}$, $\frac{7}{8}$, $\frac{9}{16}$, $\pounds 6/7/9$."

"Morris Motors. $7\frac{1}{2}\%$ Pref. 21/-, $20/7\frac{1}{2}$, $20/10\frac{1}{2}$, $-/11\frac{1}{4}$."

"Imperial Chemical. $36/4\frac{1}{2}$, -/3, $-/3\frac{3}{4}$, $-/2\frac{1}{4}$, $-/0\frac{3}{4}$, $5/11\frac{1}{4}$, etc."

"General Electric. 53/3, 5/-, 3/9, 5/6, 4/-."

The Times does not give the denomination of the shares, but the financial journals give the student this very necessary information.

PROBLEMS AND EXERCISES

1. Collect from a daily paper copies of three different types of balance sheets. Estimate (a) the proportion of fixed to circulating capital in each business, and (b) the degree of solvency of each company in the event of sudden liquidation.
2. Compare the relationship of turnover to profit and capital. Give numerical examples to illustrate your answer.
3. Enumerate some of the causes affecting the prices of stocks and shares that are not mentioned in this chapter.
4. What do we mean by the "mobility of capital?" How can shares be transferred from one owner to another?
5. What is a debenture? What kinds of debentures exist? Compare shares and debentures from the point of view of the investor and his needs.
6. Give an account of the way in which a limited company obtains the sums of money with which to carry on business enterprises.

7. Explain the meaning of the following expressions : premium on shares, calls, uncalled capital, application money, allotment of shares, preference and deferred shares, founders' shares.

8. Enumerate the different interests involved in the promotion of a company to exploit a new invention. How do the joint-stock banks abroad assist in financing industries ?

9. What are some of the advantages of joint-stock enterprise from the point of view of the man with money to invest ? What are some of the defects ?

10. What is the effect of one company absorbing others by the payment of sums in excess of the value of the net assets purchased ? Which do you think forms the better test of the capitalization of a company in a reorganization, (a) the earning capacity of the assets, or (b) their net market value ?

11. In what businesses would you expect to find great fluctuations in gross and net profits ? Why ?

12. What advantage to a company is it (a) to have a large reserve, (b) to maintain its fixed capital out of income, (c) to invest its reserves in the company ? What is a reserve ? Should reserves be invested outside the company ?

13. Is it a good or bad policy to postpone payment for repairs or depreciation during years of depression in business ? Why ?

14. Is it wise for a company to maintain a regular dividend policy ? How will such a policy affect the value of its shares ? What is the difficulty in deciding the dividend policy of a new company ?

15. Draw a diagram to show the process of financing a limited company. What is meant by underwriting an issue of shares ? What people are concerned with underwriting shares ?

16. Name the six groups of people chiefly concerned with the promotion of companies in the United Kingdom. What is usually charged for underwriting shares ?

17. What is an investment trust company ? What is the purpose of establishing such a company ?

18. How do issue houses usually sell the stock they buy ? With what special type of business enterprise are issue houses concerned ? Why are issue houses an important part of the money market ?

19. "There is nowhere a chest of gold that can alternately be spent on any one of half a dozen projects. Capital for great enterprises is the product of delicately balanced forces of supply and demand." Explain this statement fully.

20. "Speculative over-expansion of credit invariably ends in over-contraction and distress." Explain fully the meaning of this, particularly with reference to speculation in securities.

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CHAPTER IV

LABOUR AND THE ORGANIZATION OF LABOUR

The problem of human labour is the most fundamental in business economics, for human labour alone can control and modify the resources of the world and enable them to satisfy desires now and provide capital to satisfy wants in the future. Goods have to be moved and moulded to satisfy our wants.

The human effort of body or mind which is used in the production of wealth is called "labour" in business economics, and is of two kinds. First, the labour applied to the creation of a commodity, and secondly, that involved in doing a service for another for some reward. The doctor, lawyer, or teacher performs a service which is as essential to productive progress as that of the skilled artisan in the factory, the labourer in the fields, the transport worker, or the director of a joint-stock company. Labour moves matter and changes its form to give it the power to gratify human desires.

For our purpose labour can be divided into (a) that directly engaged in producing articles of commerce, and (b) that indirectly engaged in the process, e.g. the feeding, clothing, and housing of the workers, the producing of tools, the services of banking, transport, insurance, etc. For the work to be well done, the

workers must be healthy, intelligent, skilful, and disciplined. The whole process of production must also be well directed. The worker must be able to support himself and his family on the reward he reaps for his labour, or his efficiency will suffer. His working conditions must conduce to health. Badly ventilated and lighted workshops, and very long hours of work will quickly incapacitate him.

Mobility of Labour.—We have already dealt with the question of the mobility of capital. With labour we have to consider the willingness as well as the ability of the worker to move from one occupation to another. Personal factors such as the links of kinship cannot be ignored. Work may be available for men overseas, but they may not be willing to emigrate. Again, it is not always possible with the rapid changes in economic conditions to obtain work in the craft which the worker has been taught. Unemployed coalminers may not find it easy to become gardeners, agricultural labourers, or bricklayers. Governments aid the mobility of labour by collecting and disseminating information concerning work that is available, and the keeping of registers of unemployed persons.

The Division of Labour.—We have shown in Chapter II how the primitive savage works to satisfy his own wants, and how by the exchange of goods and services man varies his possessions and lives a fuller life. From the elementary division of labour into crafts has sprung the modern system under which the shoemaker in the shoe factory no longer performs

the entire process of making a shoe, but is concerned with one of scores of distinct operations. He may spend his time cutting shapes from leather, or working at one process on the heel of the shoe, or in tending a machine which sews on buttons, or polishes the heel of the shoe, or sandpapers it. He may inspect a part of the shoe when it is made. In a factory of this kind in Wellingborough the authors counted nearly ninety specialized jobs. Each man or woman engaged on one process had little opportunity of learning the work of others. Yet, curiously enough, in this vast factory one man was engaged in making a shoe from start to finish.

One form of division of labour has thus followed another. First came the division into crafts, or trades, then into industries sometimes closely associated with an area like the cotton industry of Lancashire, then into separate processes, and finally parts of processes. When workers co-operate to perform a single task, such as reefing the sails of a ship, or the mowing of a field, we describe their association as the *simple* division of labour. When each performs a specialized task like the workers in the shoe factory in order to bring about a result, we speak of the division of labour as being *complex*. Lest the student should imagine that the conception of the advantages of specialization is quite modern we may quote the following passage from Plato: "All things will be produced in superior quantity and quality and with greater ease, when each man works at a single occupation in accordance with his natural gifts." The worker

at one occupation acquires great skill and dexterity. He has not to move about from one task to another, or from one machine to another ; hence tools and machines are kept in more constant use.¹

The advantages and disadvantages of the use of machines.—No effort on the part of men working in co-operation could achieve what can be done to-day with machines. The floating dock can lift a giant steamer out of the water ; the steam shovel can dig the Panama Canal ; the motor-car can carry a man at a speed of 231 miles an hour. Machinery performs processes that are most monotonous for human beings to do. The development of skill in the handling of machines serves the purpose of education. The man who is practised in controlling one machine more quickly learns the control of another, and mobility of labour is made possible. The machine has greater precision than the hand of the worker and leads to the making of a standardized product. Output is increased enormously and the cost per unit is lowered by mass production methods. No two parts of a machine made by hand would be exactly alike and interchangeable at a moment's notice like the parts of a Ford or Austin motor-car.

But the immediate effect of the introduction of machinery may be to displace labour. The invention and use of the power loom in weaving displaced the hand weaver ; motor omnibuses threw horse-bus drivers out of employment in some cases. The process of absorption of the labour displaced has often been slow

¹ Cannan, *Wealth*.

in the past. The older men who are not so readily adaptable suffer most. The cheapening of products of consumption as a result of the introduction of machinery leaves consumers with surpluses to spend on other things. Markets for goods and services are constantly expanding and extra labour is employed in production, surplus labour being absorbed. Perhaps one of the most serious losses from the introduction of machinery is the passing of the master craftsman who took a pride in his creative work. The machine-minder can to-day be replaced at once; the old craftsman had the pride of independence. The machine can, however, do work of such a delicate nature that the loss of beauty is now the fault of the designer only, and the combined exertions of machine specialists can produce marvellous results.* Legislation has already remedied the abuses of the factory system; overcrowding, insanitary conditions, the overworking of young children, etc. Science has made possible a healthy life for workers in the towns. The death-rate of London compares favourably with that of the finest health resorts in the world.

Trade Unions.—An Act as far back as 1512 contemplated the combination of workers to raise their wages and a later Act of the reign of Elizabeth (1563) laid it down that no craft could be set up without seven years' apprenticeship, and gave power to magistrates to fix wages, hours of work, etc. The growth of new trades and new industries after the industrial revolution made the work of the justices difficult. At the beginning of the nineteenth century (1800)

Combination Acts made contracts entered into to get advances of wages, or better hours of work, void. The Acts were repealed in 1824. Not until the Trade Union Acts of 1871 and 1875, however, were associations of wage-earners for the purpose of maintaining or improving the conditions of their employment fully recognized. A trade union aims at setting up a monopoly in the supply of labour, and of substituting collective bargaining for individual contracts. In Chapter V we have shown how the trust, or combine, aims at making the single company the unit in production in order to create a monopoly and to control the supply of a commodity and fix prices. Apart from the friendly society functions of trade unions and their political activities, they aim directly at establishing certain minimum standards in different industries, and seeing that these standards are not reduced. They are able to employ skilled negotiators (trade union officials), with a full knowledge of the industry, to drive bargains for them. A trade union also collects funds from the workers to form a reserve to prevent workers having to accept unsuitable employment. They know that there are limits to the amount that can be paid in wages in any industry, and that within these limits negotiations may fix wage rates at a more or less favourable level. The growth of trade unions has been stimulated during the last fifty years in Great Britain by the spread of free education, a general rise in the standard of comfort (higher real wages, and shorter hours of employment), Acts of Parliament such as the Trade Boards Acts,

and the important positions held by the leaders of the movement.

To counteract the activities of trade unions, federations of employers have been organized such as the London Master Builders Association, and those in the engineering and shipbuilding trades. The negotiations of these employers' federations and the trade unions have tended to bring about stability in wages and uniformity in hours of work, etc.

Stoppage of work in a highly organized industrial country is productive of harm to both workers and employers. Income is lost on both sides, purchasing power diminished and other industries injured in consequence. Supplies of raw material are held up, power and transport services affected. Legislation has been passed in many countries to prevent the disorganization of industrial and commercial life by industrial disputes. Arbitration has been made compulsory in Australia and New Zealand.¹ In recent years many smaller strikes and disagreements have been avoided and settled through the negotiation of employers and employed in these huge associations; but some of the stoppages of work have been bigger and more contracted where a trial of strength has been made. Publicity is of great value in preventing the outbreak of strikes and lock-outs; and arbitration and conciliation may bind the parties to accept temporary settlements of disputes while they are being investigated. In the case of the Trade Boards

¹ Political influences have interfered with the effective working of these Acts.

Acts, legal machinery exists in certain industries in the United Kingdom to settle problems of wages, etc.

After the war it was proposed to establish Joint Standing Industrial Councils (Whitley Councils) in all industries. These were to consist of two chairmen (one a vice-chairman) and equal numbers of employers and employed. They were to meet at frequent intervals, and by means of works committees in all factories, district and national councils, help in the adjustment of labour troubles. A Government liaison officer was to be appointed to keep the Ministry of Labour informed of the progress of the negotiations. The better organized trade unions, like those connected with mining, engineering, the iron and steel industries, cotton manufacturing, and the railways, have their own organizations for dealing with difficulties.

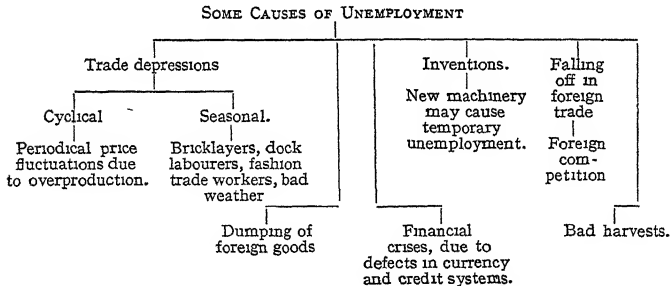
The level of wages in most industries is still largely fixed by custom and the level of wages in similar or contributory industries. Employers are alive to the advantages to be gained from the establishment of adequate machinery for the effective regulation of wages throughout a trade. The Trade Boards set up under the Acts of 1908, 1913, and 1918, may fix such things as the general minimum piece rates paid in an industry, the guaranteed time rate, overtime rate, and the wages paid to young learners.

Unemployment.—Unemployment is on the whole confined to wage earners and manual workers. The salaried classes do not feel the results of the periodic trade depressions that occur in our economic organization as acutely as the wage earner and mechanic.

Temporary changes in the structure of industry and commerce, variations in the demand for machine-made commodities, ships, tools, and buildings, bring about changes in the demand for labour in these industries. The problem of unemployment thus increases in gravity as a community evolves from the agricultural to the industrial stage of development. France, with a population of 39,000,000—of whom 49 per cent. are directly engaged in agriculture—has little unemployment. The problem of unemployment engages more and more the attention of governments and economists, on account of its evil effects on the community :—

1. It reduces the standard of living of large numbers of people.
2. It causes injuries to the health and physique of sufferers.
3. The fear of unemployment is a canker which destroys all joy in work.

Some Causes of Unemployment.—Involuntary idleness, owing to lack of work at a normal wage, may be brought about by seasonal and cyclical fluctuations



in the demand for labour, financial crises, bad harvests, a falling off in foreign trade, competition of industries abroad, in addition to the causes already mentioned.

Enforced idleness is at all times a great waste of the productive resources of a community: factories are idle, land is untilled, purchasing power is reduced, and other evils brought about which we have already mentioned. The need is felt for some greater measure of public control which will keep the economic system working more steadily, but as yet we have not found a way of organizing industry so that each shall look after its own unemployed and insure that the industry shall have only the right number of men desiring employment therein. The amount of work available is not fixed, but varies from time to time; and the demand for work is not increased by making other men and women accept lower wages or work longer hours. As the output of a country increases, so does the demand for labour. The cotton industry is so well organized that it can regulate the hours of work during good and bad times. The Labour Exchanges of Great Britain assist workers in finding employment, and the Unemployment Insurance Acts of 1911 and 1920-21 have helped to mitigate the worst evils of our industrial system.¹ But the ultimate solution may lie in the regulation of employment by the industries themselves. Provision may have to be made during good periods to tide the workers over the periods of depression.

¹ "Unemployment insurance is wrongly called a dole. It is a scheme to which employers, employees, and the State have contributed in the proportions roughly of 40, 35 and 25." C. R. Fay, *Gt. Britain from Adam Smith to the Present Day*, 1928, p. 88.

The supply of labour to an industry may be controlled, and provision made for surplus workers overseas.

The post-war depression of 1921 was sudden and acute, more severe than that of 1908-9, because the boom in trade in 1919 at the end of the war was "feverish and speculative". Men "ordered two or three times as much as they wanted in the hope of obtaining something like the amounts they really required." They "bought shares indiscriminately in fresh concerns, in reconstructed companies and in new amalgamations".¹ Prices of raw materials were high, wages soared, the currency was inflated, and the rate of output was low in many industries.

It is generally agreed that in every industry there should be "a permanent organization for bringing employers and employed together, not merely for the settlement of disputes, but for the consideration of all matters affecting the good conduct of their common enterprise."²

PROBLEMS AND EXERCISES

1. Why do modern industries tend to concentrate in towns? What developments of recent years have led to the growth of industries outside the large cities of Great Britain?

2. "In a factory town where the labour of one sex is exclusively employed, other industries will frequently spring up to utilize the labour of the opposite sex." What instances of this process can you find?

3. What other influences besides "scientific location" have led to the concentration of industries and population?

¹ Knoop, in *Discovery*, 1921.

² Viscount Milner, *The Observer*, 7th Jan., 1923.

4. What efforts are being made to-day in industry and commerce to get "the right men for the right jobs"? (Vocational guidance)

5. Look up the records of the National Institute of Industrial Psychology in the local Library and make a list of experiments that have been made to improve the output of industries by the careful study of the movements of workers, and the elimination of unnecessary motions. How has the cinema helped in these investigations?

6. Give all the reasons you can why men should be effectively occupied. Why is it as necessary to use our human resources rightly as our natural resources and our capital?

7. How are human resources wasted by voluntary and involuntary idleness? Give instances.

8. Why is involuntary idleness (unemployment) a concomitant of industrial development? Give at least six reasons.

9. In New York State (U.S.A.) in 1911 a Commission estimated that "in ordinary years of business prosperity", forty per cent. of the workers are not in regular employment. Account for such a state of affairs in normal times.

10. What effect has the leadership and incentive of the captain of a football team on the work of his men in a hard struggle against another team? Does initiative, or incentive, play a part in the leading of men in modern industry and commerce? How? Have games any connection with individual efficiency?

11. What do you think is the effect of accidents in wasting the time of workers in modern factories?

12. Why does the worker fare better when capital is well employed?

13. Give instances of enforced idleness of workers due to the inability of capital to be effectively employed.

14. Which incentives to work would you think were stronger, the wage a man or woman receives, pride in work, consciousness of achievement, loyalty to leadership? What will be the result if all these incentives are present?

15. Why should it be our aim in an economic society to banish poverty and its tragic consequences? Show how the evils of poverty are cumulative.

16. How are modern governments seeking to prevent the

waste of human resources? Give your answers under the following headings: (a) accidents, (b) sickness, (c) housing, (d) medical inspection.

17. How does insurance of all kinds tend to reduce unemployment?

18. Estimate the effects of publicity and employment agencies in reducing unemployment.

19. How have trade unions helped to promote the welfare of their members? Discuss fully the three main directions in which benefits have been bestowed on the workers, and the efforts of trade unions to procure legislation forbidding child labour, excessive hours of work, etc.

20. Discuss the reasons for establishing a "personnel department" in a large business unit. What would be the duties of the director in charge of this department? Draw a diagram to illustrate your answer.

21. Mention four methods of paying workers by results. What are the conditions favouring the introduction of piece rates? Why cannot the increasing rate system be carried beyond a certain limit?

22. What is the doctrine of the "economy of high wages"? Is the danger of competition of the low-paid labour of the East a real danger to industries in the United Kingdom? How could such a danger be combated? What is the result of low-paid labour in most cases?

23. Lord Leverhulme said: "The way to increase the wants of the worker is to increase his leisure." Is this true? What influence on the national prosperity might an increase of the leisure of the worker have?

24. Why is the working of overtime discouraged by trade unions?

25. Why is the diminishing piece-system most commonly put into practice? What do you know of bonus systems of wage payments? How may the bonus be paid?

26. What is the difference between profit sharing and schemes of co-partnership?

27. What two main groups of factors govern the efficiency of labour? What are some of the external factors? In what cases is it difficult to measure the output or efficiency of labour?

28. Why is labour more efficient in the United States

of America than in the United Kingdom when the capacity of the individual in the two countries is roughly equal?

29. Education has been described as "an investment in human capital". How far is this true? Does a good educational system increase the productive power of a community? Did education play any part in bringing about the industrial revolution? Ought we to extend the meaning of education?

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CHAPTER V

GROWTH IN SIZE OF THE BUSINESS UNIT

The continued expansion of industry under the influence of new inventions, and the more scientific use of the resources of nature, call for a discussion of the tendencies of modern businesses to grow in size and complexity.

The advantages of the division of labour in production were so clearly seen at the time of the industrial revolution that in the cotton industry in England to-day we have an example of extreme specialization right from the buying of the raw cotton to the ultimate selling of the finished goods. At each stage of the process of buying, manufacturing, and selling we find large business units: brokers, dealers, spinners, yarn merchants, weavers, bleachers, dyers, printers, packers, merchants and shippers. All these men and women live by the making and marketing of the cotton cloth, but most of them are far removed from the customers who will buy what they make. Before the Great War Lancashire was supreme in the cotton exports of the world. To-day Lancashire feels keenly the competition of other countries like Japan, where the process of mass production and mass distribution is fully understood and developed. The union of the various sections of the industry in Lancashire would appear to be the

only way of fighting this fierce competition, but according to Sir Kenneth D. Stewart,¹ there is danger of "causing disaster by introducing large changes of structure in the cotton trade". The capital involved in the unification of interests is immense as we have pointed out in the previous chapter ; and the problem of handling the capital and labour becomes so difficult that changes in the structure of industry may be fraught with grave perils.

Let us glance back at the early organization of business again to see whether light can be thrown on this continued growth in size of businesses. In the middle ages the individual traders or craftsmen were organized into Gilds—Merchant Gilds and Craft Gilds. These Gilds were formed to maintain the status of their members, to protect them against oppression and competition, and to act as social organizations working for the benefit of all the members. "They were equally severe on incompetent workmen of their own craft, or persons who used worthless material in the making of their goods."² Each member of the gild was self-controlling ; he worked on his own account ; the sole traders were loosely organized to safeguard their industry. The industrial revolution altered this organization of the business unit. People who could not command the necessary capital were compelled to work for a wage, and to serve an employer, or groups of employers combined to form a partnership or company. The big

¹ Chairman of the Lancs. Cotton Corporation.

² Lord Mayor of London, 1929.

overseas trading companies dating from the time of Elizabeth were formed to carry on trade abroad that was full of risks. Men united to meet these greater risks, and royal favour helped in their development, for current economic theories favoured foreign trade.

These regulated companies were in many ways the precursors of our large joint-stock companies; except that in most of the regulated companies there was no merging of the individual into the new personality of the joint-stock trading company. Each member of the regulated company preserved his individuality; he agreed to co-operate with his fellow traders for the purpose of mutual protection.

The great chartered companies of English merchants in the reign of Queen Elizabeth, such as the Levant or Turkey Company (1581), the East India Company (1600), the Muscovy Company and the Barbary Company, were groups of merchants chartered by the Queen to monopolize the trade in the different regions of the world and reserve for England the trade carried on by foreign merchants. The merchants subscribed towards the common expenses of the regulated company, but, as we have said already, each traded on his own and preserved his individuality. In 1612, however, the members of the East India Company created a common stock and for some years traded as a joint-stock company which was managed by a Board of Directors. By the eighteenth century the trading monopolies had grown obsolete, for "industry had become national and commerce international". The companies had served their purpose in developing

international commerce, and their privileges were now made available to all merchants in England. The Hudson's Bay Company was able to maintain its monopoly right down to 1869, and prospered as a joint-stock company. Notwithstanding these joint-stock enterprises of the great commercial companies, it is true to say that up to the beginning of the nineteenth century the typical business unit was the sole trader, or a partnership of two or more traders : the business was personal and employers were in direct contact with employees and entrepreneurs.

With the progress of the Industrial Revolution at the beginning of the nineteenth century, the growth of population owing to internal prosperity, and scientific farming, England's powers of production developed enormously, and the business unit became larger and larger. In the larger companies the contact between employer and employed tended to become less personal, and the older social system gradually collapsed. Under a system of free trade Britain manufactured goods for the world from the raw materials received from other countries, and found employment for a growing population of British workmen and increased enormously the profits of British capitalists. Legal protection of the individual shareholder gave an impetus to people to save and invest their money ; industrial undertakings prospered, and industry increased by leaps and bounds. It must be noted that limited liability companies enabled people to spread their investments, and also enabled industrial undertakings to draw their capital from a

wide area. Once the principle of limited liability was established in European countries and in the United States an industrial revolution of world-wide extent began.

Two social results of the growth of the limited liability company should be noted :—

1. The employees become still further separated from the persons controlling the capital of the company, and are placed under the control of a paid manager who often has little interest in their welfare.
2. As a corrective to the dominance of capital, and its control of the economic life of the people, there emerged unions of workers, under the guidance of skilled negotiators, for collective bargaining with employers.¹

THE DIFFERENT KINDS OF COMPANIES

It has been shown that the Company is the main element in the growth of business enterprise in modern times, and the different types of company organization should be noted. We have made reference already to the companies incorporated by Royal Charter. These are in law in the same position as individual traders. The Charter contains the rules restricting the activities of the corporation, and the Crown may revoke the Charter at any time. Other companies, such as the Railway Companies, require the authority of Parliament in order that they may acquire property compulsorily. These companies are statutory bodies,

¹ The organized labour movement has not made great headway in America yet, because of the greater opportunities open to the workers of improving their economic position.

and are controlled by Acts of Parliament. Another kind of company is the building society, or friendly society. And finally we have the ordinary business company in its three forms: (a) the company that is unlimited as regards the liability of its shareholders, (b) the limited liability company, and (c) the company limited by guarantee. The limited liability company has also two forms: the private limited liability company and the public limited liability company.

The private limited company must satisfy three conditions: (i) it must restrict the right to transfer shares, (ii) the number of members, exclusive of employees, must be limited to 50, and (iii) it must prohibit an invitation to the public to subscribe for its shares or debentures. Such a company may consist of two or more shareholders only. Many sole traders, in order to protect their private estate from the bad consequences of bankruptcy, have formed themselves into limited liability companies. In many of them practically all the shares are held by one man.

For larger enterprises, which intend appealing to the public for capital, a public limited company is formed. It must consist of at least seven members, and is subject to more stringent regulations under the Companies Acts.¹ All the companies whose prospectuses appear in the daily papers are public companies.

In the company limited by guarantee, each member undertakes to provide a fixed amount in the event of the winding up of the company. They are formed

¹ 1908, 1917; 1928.

for the most part for the development of social or intellectual activities, and are relatively very few in number.

Throughout the present century there have been two tendencies at work in the development of joint-stock enterprises : first, an increase in the number of joint-stock companies as a whole (both large and small) : second, an absorption of the smaller companies by the larger, and the amalgamation of the larger companies. The increase in the variety and quantity of wants in the last two decades, coupled with the creative ability of a new generation of inventors, has been responsible for the vast increase in limited liability companies.

TRUSTS AND COMBINES

In the larger services of modern economic life and in the manufacture of commodities of national and international consumption, a process of absorption has been going on for many years. Many of the small companies have not been able to withstand the fierce competition through lack of capital, the inability to keep pace with modern methods, and the lack of able directors. One by one they have disappeared as they were bought up by the larger concern. Sometimes the name of the smaller company is retained, but the control goes to the directors of the larger company. In many cases the disappearance of companies has been due to new discoveries which have rendered the old process or commodity obsolete.

Since the War many of the largest companies engaged in producing or distributing similar commodities and services have joined together to prevent all of them being ruined by competition. So simple and yet so subtle are the methods whereby one company either controls, or amalgamates with, another company, that the public is hardly aware of what is taking place. One is surprised to find that in dealing with "X", one is really buying from a company "A", of which "X" forms a part. This control of one company by another may be achieved by the purchase of the bulk of the shares of one company by the directors of another, who issue what are called debentures (see page 38) against them. The holding company does not hold the property of the other company, but its shares. Where amalgamation has proceeded to such a point that a particular company controls the greater part of the production of a commodity, or the control of a particular service, e.g. railway transport, banking, etc., a trust is said to have been formed: i.e. an amalgamation of companies under the control of one directorate which controls the greater part of the national or international output. Adam Smith, in his *Wealth of Nations* (1776), foresaw that joint-stock enterprise would be most successful under conditions of monopoly, where operations were capable of being performed automatically, and in banking, insurance, canals, waterways, etc.

If a trust controls the whole of the output of any industry, it becomes an absolute monopoly. In practice there are few absolute monopolies for the reason that

the public can generally substitute the consumption of one article for another. If for example a powerful trust is formed to control the purchase and sale of the meat supplies of the world, we might say that an absolute monopoly had been formed in the meat trade. But there are alternatives to meat as an article of food : fish, fresh vegetables, bread, etc. The meat monopoly would not be a food monopoly, and would concern itself mainly with the problem of prices of meat alone.

It will be realized that a monopoly may be exercised for the public good, or the public harm. A monopoly gives the owner the right to charge an arbitrary price ; as he can control the supply he does not fear competition in the industry. But the monopolist does not necessarily charge a high price per unit for the goods he makes ; a high price might so reduce the consumption that he would ultimately lose money. The monopolist aims at selling as large a quantity as possible, and in order to do this he generally lowers his price, making a smaller profit per article, but a large total profit. In short, he aims at a small profit on a larger turnover. By this means his total profit may be greater than if he charged a high price and sold only a fraction of the quantity. It is possible also that the public as a whole may derive considerable benefit from the existence of a monopoly in that the price charged may be less than that of competing firms. It is a maxim of production that the greater the quantity of goods manufactured in one establishment, the smaller will be the cost per unit (see Chapter XV).

On the other hand, many arguments can be adduced

against the progress of trusts. Special legislation had to be introduced in the United States to limit the power of trusts.¹

It must not be thought that the joint-stock company is necessarily more efficient than the private individual. We have shown how the joint-stock company has grown because of the facilities for obtaining capital.

In England the amalgamation of companies along horizontal lines is proceeding apace. Railway companies have been grouped together to avoid unnecessary competition. Banks have been drawn together. Imperial Chemical Industries, Ltd., was formed in 1926 from thirty-four independent companies, with a total capital of £56,728,000. This company continues to extend its wide interests; its capital in 1928 was £65,000,000, and its profits nearly £5,500,000.

When one company creates subsidiary companies to perform certain operations in connection with processes of manufacture and transport services, we have what is known as a vertical combination. Lever Bros. started in 1890 as a soap works. Associated companies created by this company control subsidiary industries. Not only do we find an association of over forty soap companies in this huge combine, such as Pears, Knights, Crosfield, but also companies concerned with the production and the transport of the raw materials used in the making of soap, and companies formed to exploit the by-products.

¹ The Sherman Anti-trust Law of 1890 declared that "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal."

Companies may be linked together in various ways :—

1. One company may create subsidiary companies, as in the example of Lever Bros. above.
2. A company may purchase a majority of the shares of another, and so obtain power to control it.
3. Directors of one company may be appointed to the board of another.
4. A holding company may be formed to buy up the shares of a company and issue shares or debentures against them.
5. The assets of one company may be purchased by another.

The amalgamation is generally termed a “merger” when the constituent companies disappear, though the word is loosely used to cover any large amalgamation of industrial and commercial interests. The United States Steel Corporation is a good example of a merger: American steel works, iron mines, coal mines, railways, were all merged into the Steel Corporation. Such a process of establishing one unit of management combining processes of production which are complementary is termed “the integration of industry”, or “vertical combination”. A series of large stores under a single management, like those of the Selfridge Company, is known as a “horizontal combination”.

The government report on trusts (Cd. 9236, 1919), calls attention to the economic advantages that may be derived from combination.

BUYING

1. The companies are assured of a steady supply of material.

2. The buying departments and staffs of the associated companies are unified.
3. Purchases may be made in bulk.
4. Greater opportunity is afforded for comparison and selection in buying.
5. Better discounts and cheaper credit may be obtained by the combination.
6. Materials may be standardized.

MAKING

1. Products may be standardized.
2. Specialization is easier.
3. Plant is more readily improved.
4. By-products may be utilized.
5. The work of manufacture may be more equally distributed among the companies.
6. The quality may be improved.

SELLING

1. Economies may be made in transportation.
2. The selling departments and staffs of the associated companies are unified.
3. Export trade may be more rapidly extended.
4. Advertising may be done collectively.
5. Fewer middlemen lower the costs of distribution.

KNOWLEDGE

1. Data and experience may be exchanged.
2. Costing systems can be standardized.
3. Trade statistics may be collected and distributed.
4. Scientific and technical research are promoted.

The close of the nineteenth century saw the increasing growth of concentration of industries, and the growth of monopolies, trusts, cartels, and syndicates of all kinds. It must not be imagined that associations for fixing prices and controlling output were unknown

before this period ; as far back as the beginning of the nineteenth century we find the Newcastle Coal Vend, a strong organization possessing all the characteristics of a modern cartel. On the whole it is true to say that the rise of giant organizations is a feature of the last forty years.

Let us summarize the processes which have been at work during the last thirty or forty years in the industrial and commercial organization of every progressive nation :—

1. A tendency towards the concentration of industry and trade in the hands of a limited number of business concerns—the combining of similar companies and firms in the same industry and trade. This process is known as horizontal combination. The pig-iron industry in England is an example of horizontal combination. In 1865 there were 629 furnaces producing 6·3 millions of tons of iron. In 1923, this number had been reduced to 203, producing 7·4 million tons of iron.
2. The amalgamation of larger industries into associations known either as trusts, or cartels. A trust is the amalgamation of a number of separate companies into one big concern, controlled by one directorate. A cartel is an association of producers who retain their individuality, but who agree to arrange prices for all, areas of sales, output, etc. The Portland Cement Trust—the Associated Portland Cement Manufacturers—is a typical example of a British trust. Most of the smaller cement manufacturers have amalgamated, or have been bought up by the trust. Although the trust controls from 80 to 90 per cent. of the output of cement in this country, it is not an absolute

monopoly ; a competitive price is still maintained by the opposition of one or two rivals, and by foreign competition. An example of a British cartel is the National Light Castings Association, founded in 1911, to prevent undercutting of prices. The cartel aims at fixing minimum prices, allocating output, fixing sales areas and discounts granted to customers.

3. The third tendency is for the combine, trust, or cartel to gain further monopoly power by amalgamating with industries which supply the raw materials or partly manufactured goods. One of the best examples is the United States Steel Corporation which controls the production of an enormous variety of iron and steel goods, sources of supply of iron ore, railways, coal mines, steamers, etc.
4. The movement towards horizontal and vertical combination of powerful joint-stock enterprises is called *Rationalization*.

THE CO-OPERATIVE MOVEMENT

The founder of the British co-operative movement was Robert Owen, who, starting as a draper's assistant, became a great employer of labour at the end of the eighteenth century (1799). Owen firmly believed that the welfare of society depended on the better treatment of workmen, and the improvement of their environment ; and he taught that the welfare of the whole social body must be the conscious aim of each individual member of it. For this reason he and his followers were called "socialists". Owen's cotton mills, founded in New Lanark in 1799, were strikingly successful for many years. The hours of labour of workers were reduced, the children of the workers were educated, and the general condition of all greatly

improved. Robert Owen had visions of a new industrial world, and his teaching of self-help powerfully affected the working classes, who began to found co-operative societies. Nearly 500 "union shops" were started at the beginning of the nineteenth century. The workers bought provisions at wholesale prices and retailed them to one another at prices which left a margin for the supply of further capital. Prominent among the objects of these societies was the better education of the workers. The movement died out, however, for the law gave their property no protection, and private ownership of capital led to a waning of enthusiasm on the part of co-operators.

The Rochdale Pioneers.—The spirit of co-operation revived in Rochdale in 1844 in spite of the failure of a previous society in the town. Twenty-eight poor men collected a capital of £28 by small subscriptions of 2*d.* and 3*d.* and opened a small shop in Toad Lane, Rochdale. Though these pioneers did not succeed in their second aim of founding a self-supporting community, it is true to say that from this beginning grew the British and foreign co-operative movement. The pioneers began in a very small way; each took his turn of serving in the shop. Their methods of dealing with profits were in advance of those of the earlier co-operators. The pioneers decided to pay 5 per cent. interest only on the loan and share capital, and to divide the rest of the profit among the members in proportion to their purchases. Thus all members were interested in purchasing at the store and in introducing new customers.

New co-operative stores were founded on the " Rochdale plan " in all parts of the country and in all parts of the world. They are controlled on democratic lines, and have done wonderful work for thrift and the prosperity of the working classes. They have also served as schools in which working men could be trained in the economic control of business enterprises. Many of the societies set aside a portion of their profits for educational purposes. Most of the societies are members of the Co-operative Union, Limited, which derives its income from sums contributed by the principal co-operative societies. The Co-operative Union looks after much of the educational work, and the Parliamentary interests of co-operators.

The Co-operative Wholesale Society was a trading federation founded in 1863. In addition to its trade in merchandise it owns factories, warehouses, land, steamships, and banks, and is the chief user of the surplus capital of the successful stores. The 1,267 retail distributive societies in Great Britain at the end of 1927 had over $5\frac{1}{2}$ million members, owning £110,000,000 in share and loan capital. These societies employed 158,000 workers, and paid £20,500,000 in wages and salaries. Their sales amounted to £200,000,000, yielding a surplus of £23,500,000. The Co-operative Wholesale Societies in 1927 had a share and loan capital of £62,310,000, employed 49,000 people, and paid £7,600,000 in wages and salaries. Their total distributive trade was valued at £105,000,000, and their production at nearly £40,000,000.

PROBLEMS AND EXERCISES

1. "The main factors in tin rationalization are (a) modernized equipment, (b) economical units of production and distribution, (c) sound finance, and (d) increased statistical knowledge." Estimate the importance of each of these factors, and show how they will react on (i) the reduction of the cost of producing tin, and (ii) increasing the output of tin.

2. What would happen in the tin industry if prices of tin fell very low as a result of rationalization? How can such an eventuality be prevented?

3. "It is owing to the pressure of world circumstances that the rationalization movement is proceeding more rapidly to-day." What is the object of rationalization, and what does it involve? What will most probably arise as the movement grows?

4. In what industries does there seem to be a tendency towards a continuous growth in the size of the business unit? Give examples.

5. What two kinds of expansion are possible in business? Distinguish between them.

6. What are the advantages of vertical expansion?

7. Enumerate the conditions that tend to favour the growth of large-scale enterprises.

8. Contrast the regulated companies of the sixteenth and seventeenth centuries with the large joint-stock companies of to-day.

9. Discuss the ways in which large businesses can be (a) useful, and (b) detrimental to a community.

10. Give examples of (a) absolute monopolies, (b) partial monopolies. With what forces do monopolies have to contend?

11. Give an account of some of the recent amalgamations which have taken place in Great Britain and the United States in commerce and industry.

12. How does a monopoly tend to fix prices? What conditions will influence the monopolist in fixing his prices?

13. Give instances to show that small traders can thrive side by side with the large joint-stock companies. Why will this state of affairs probably continue?

14 How would a cheap and widely distributed system of electric power affect the size of the business unit ?

15 In what ways do large commercial organizations benefit the conditions of the worker ?

16 How can industrial combinations of all kinds be classified from the financial point of view ? What is a combine ? What is usually lost when an old-established company is absorbed by a combine ?

17. What do you know of the growth of the United States meat packing industry, or the United States Steel Corporation ? Discuss the expansion of these industries in the light of the factors given on pages 68-70. What are some of the by-products of the Chicago meat packing industry ?

18. Why do not all industries tend to grow larger ? Mention industries in which you would expect the unit to be small.

19. What are some of the advantages accruing to a company controlling a whole series of hotels, or a chain of stores ?

FURTHER READINGS AND REFERENCES

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CHAPTER VI

VALUE AND THE MECHANISM OF EXCHANGE

It has been explained in Chapter I that in primitive societies comparatively little exchanging of commodities or services takes place. With an increase in specialization in the manufacture of commodities, exchange becomes the most significant function of the economic life of the community; value the vital problem of an advanced civilization.

The example of the making of a watch (p. 6) demonstrates the truth of the principle that exchange is the logical result of the division of labour in production. Under modern conditions of manufacture a man may never consume one of the articles he makes; but we should always bear in mind that he needs to exchange the things he manufactures for others that will satisfy his wants more effectively. The business man of to-day is so accustomed to expressing the value of the things bought and sold in terms of a money price—and is guided in his activities by the rise and fall of prices—that it is well to consider the meaning of money and to get a clear conception of what is meant by value.

Anything that satisfies a human want or desire is said to have utility, but in business economics we are concerned with the value of services and goods

that can be exchanged for the services and goods of others. The savage exchanging skins for beads and other luxuries may quite well use skins to measure the value of the other articles. The owner of flocks of cattle and sheep in the pastoral age, may measure value in terms of cattle. Some things may have no value in exchange as they are unlimited in quantity, and can be got freely without exertion. The student must not quarrel with us either for not attempting to place value on happiness, love and health, for though these are of inestimable worth to each one of us, we cannot measure their value in terms of any commodity or by means of placing a money price on them. Value in business economics applies to all things that are desired, are limited in quantity, and are capable of being transferred from the ownership of one person to that of another.

Value is a relationship existing between two commodities—a ratio of exchangeability. It therefore represents the degree of intensity with which persons want an article "A" in reference to another article "B" (assuming that the supply of each article is the same). For convenience it has become customary to measure the value of all articles and services in terms of one commodity, money, and this value is stated as a "price".

It is impossible in this book to consider even in the barest outline the theories put forward by economists for the determination of the value of commodities. Suffice it to say that the value, or more popularly the price of anything, is determined in the long run by

the group of forces affecting the supply or quantity of the commodity offered on the one hand, and the group of forces affecting the demand for that commodity on the other.¹ The determination of the "price" of anything is a matter of everyday experience of the student. A new fashion appears in women's dress; women rush to buy this latest design. The supply of this particular model is naturally limited at first, and is not equal to the suddenly increased demand, with the result that in competing with one another for the purchase of the dresses, buyers force up the price. After a period of time, when manufacturers have had time to increase the stock of this particular dress, the shops in competing with one another to sell the article will lower their prices. This is another way of stating the maxim that when supply falls, demand being constant, prices rise; and that when supply increases, demand being constant, prices fall.

Where the number of articles is legion, and the daily exchanges run into millions, some commodity which everyone will accept and which serves as a measure of the value of the articles exchanged is necessary to facilitate these exchanges. The commodity which is generally acceptable as purchasing power at any particular time at any place is called *money*. If this

¹ "A small surplus or deficiency makes a difference in market price that seems excessive in proportion to the quantity offered, at any rate in the case of commodities that are essential to consumers. For instance, while the quantity of chilled beef imported from all countries last year was down 8 per cent. from 1927, the value in this country was up 16 per cent. according to the Board of Trade returns."—Sir Wm. S. Haldane, *The Times*, April, 1929.

idea of money is kept in view the student will not be puzzled by the various forms which money takes: coins, bank notes, treasury notes, tokens of all kinds in different countries at different periods of the world's history. The cheque which is so much used in England for the settlements of exchanges of goods and services can hardly be termed money, for cheques are not readily acceptable by anyone who is not familiar with the drawer of the cheque. But cheques form a part of the circulating media of exchange in many countries, and therefore form a part of the "currency" as it is called.

In remote antiquity coins were used as money. Emperors had their own portraits impressed on pieces of metal, of gold, silver, and bronze, and these passed readily from hand to hand, and were found so convenient in practice that they were used to assist in regulating the exchange of goods. It must not be overlooked that the value of money itself can be measured in terms of other commodities. If more coal, potatoes, and bread can be bought tomorrow with the same amount of money that we spent on them to-day, it is true to say that the value of money has increased in the two days. It is a curious fact that for thousands of years men have continued to desire gold. Gold has for centuries possessed a high exchange value in relation to other commodities, and on account of the qualities of gold it serves us even to-day as the basis of value. Gold bullion is international currency which helps to facilitate the world exchange of goods, but few

countries want to make it easy to send gold out of the country for reasons which will be evident to the student later. So high is the value of gold in all countries that it can be carried all over the world at a very low relative cost¹; its value consequently remains fairly constant everywhere.

But it is inconvenient to use gold for all exchanges of commodities: silver, bronze, nickel, and tin are all used for the settlement of business transactions where low values are involved, and paper money, in the form of bank notes, treasury notes, etc., which are in effect receipts for gold and silver, came into use with the improvement of the standard of business morality in civilized communities, for alterations in currencies can only be made as public opinion allows. It would be useless to try to use a piece of paper as money if people had not faith in the bank or government or person issuing it. The first bank notes in England were the "goldsmiths' notes" given in exchange for the deposit of gold bullion and the surplus wealth of merchants. The goldsmiths undertook to return the money to the bearer of the notes when he desired it.

The establishment of the Bank of England, in 1694, marks the beginning of joint-stock banking in England, and the issuing of bank notes backed by the government. With the spread of banking from 1750 onwards (due to the Industrial Revolution), other

¹ "Rates for the shipment of gold from Durban to Bombay have been reduced from 12s. 6d. to 10s. per cent."—*The Times*, March, 1929.

banks acquired the right to issue notes, often with disastrous effects. The goldsmiths had soon discovered that they could lend out at interest more money than had been deposited with them, for only a few of the people leaving their gold with the goldsmiths demanded the return of it at any one time. The ease with which notes could be printed led to abuses ; many banks over-issued notes and failed to cash them into gold when they were presented for payment. This led in the end to the Bank of England acquiring almost the sole right to issue notes (see Chapter VII, p. 97).

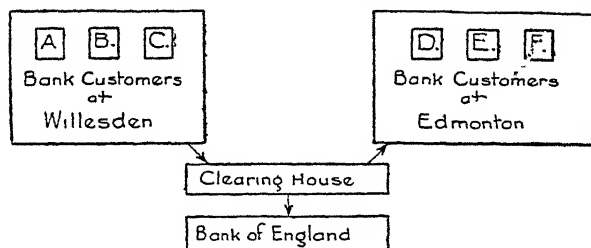
An act of 1826 allowed the setting up of joint-stock banks outside a radius of 25 miles from London. Their liability was unlimited, but the banking system as we know it to-day began seven years later, in 1833, when joint-stock banks were permitted in London itself.

The issuing of notes by English banks has now been largely superseded by the use of cheques. This implies a further step forward in commercial morality and good faith. A person accepting a cheque does so on the good faith that the drawer of the cheque has a banking account, and that it will be honoured (cashed by his banker) when it is presented. The cheque system is an easy method of settling a debt : a cheque may be made out to any amount, to any person, and can be rendered safe by merely drawing two lines across it. The cheque in effect dispenses with the use of money in the settlement of business transactions, for the indebtedness of A to B is cancelled by the making of a record in the books of the bank. It is not surprising, therefore, that as banks have grown,

and people have developed the habit of making payments by cheque, an enormous volume of transactions is settled by this means each day. Some countries still prefer to use bank notes, because they are more widely acceptable. A moment's thought will convince the student that without the use of notes and cheques modern large-scale business could not be carried on. Gold does not exist in large enough amounts to enable the exchange of commodities to take place by its use, and it would be most inconvenient to use gold for the purpose.

How the Cheque System Works. The London Clearing House.—The settlement of the indebtedness of one bank to another, owing to the drawing of cheques on one bank and the paying of them in to another, led to the establishment about 1775 of the London Clearing House. In 1854 the joint-stock banks were admitted, and in that year the settlement of differences by records in the books of the Bank of England originated. The Clearing House is situated in Post Office Court, Lombard Street. Its origin is obscure: it probably arose as a result of the unauthorized meetings of clerks who assembled to settle claims between the private banks. In the absence of some such organization, each bank would have to present cheques on each of the other banks in order to cancel its debts.

If we trace the course of a cheque on its journey from the person who draws it to its final cancellation, we shall see how the Clearing House system works.



The customers of banks in Willesden and Edmonton are represented by the letters "A.B.C." and "D.E.F." respectively. If Mr. A., in Willesden, owes Mr. E., in Edmonton, a sum of money, and draws a cheque on his Willesden bank and forwards it to Mr. E., the cheque is paid in to the Edmonton bank. The Edmonton bank will at once credit Mr. E.'s account and debit the Clearing House.¹ The cheque will then be sent to the Clearing House where it will be credited to the Edmonton bank and debited to the Willesden bank. The cheque is now returned to the Willesden bank, which will credit the Clearing House and debit Mr. A.'s account. Thus by a series of entries in books, the indebtedness between the two banking houses is settled, each bank remaining either a debtor or a creditor of the Clearing House. Now imagine this process carried out with thousands of cheques each day. At the end of the day the Clearing House can add up all amounts due to the Clearing House from other banks, and the amounts which it owes to other banks. To make the final adjustment of indebtedness easy, the Clearing House and the clearing banks all

¹ Through the Head Office of the Bank.

have accounts at the Bank of England. The difference shown on the day's accounts can be adjusted by a cheque drawn by the Clearing House on the Bank of England. If as a result of the day's transactions, Willesden bank owes Clearing House £10,000, a white form—somewhat similar in form to an ordinary cheque—is drawn on the Bank of England transferring £10,000 from Willesden bank's account to the Clearing House. If the Clearing House owes Edmonton bank £10,000 a green form is drawn on the Bank which then credits Edmonton and debits the Clearing House.

The Clearing House is therefore a vital organization to a cheque system. By facilitating the cancellation of debts it quickens exchange, and obviates the cumbersome method of giving coins in exchange for goods; more purchases and sales can be carried through in a given period. Moreover, the simplification resulting from the smooth working of the Clearing House system tends to increase trade, increase production, and contribute to the general prosperity of the country. The amount of exchanging that is done each day—the amount of the purchases and sales—is indicated by the Daily Return of the Clearing House which is published in financial and other newspapers. Cash purchases and sales would not of course be shown in the Clearing House return, but these represent a very small portion of the total business of such a highly developed country as England.

Credit.—If a person for any reason has the right to draw a cheque on his bank to the value of £100, that person has in effect £100 worth of purchasing power

(see definition of *money* on page 81). Hence each additional cheque that may be drawn for £100 means that the purchasing power of the community is increased by £100.

Let us assume that Jones opens an account with his Banker by depositing securities (see page 39) to the value of, say, £1,000. The form of security, whether coins, a cheque drawn on another bank, or the title deeds to property, does not matter for our purpose. Jones has now the right to draw cheques against this £1,000, and of handing them to his creditors. He is allowed to continue to draw cheques until his £1,000 is exhausted. Now, let us assume further that the banker knows Jones to be a good man of business, and that Jones, in order to put up another factory, or extend his present premises, asks his banker to lend him another £1,000 to be repaid in one year's time when Jones has increased his trade. In addition to possessing a sound character as a business man, Jones has the title deeds of his first factory and deposits them with the banker as security for the debt if the venture should fail. The banker may have such confidence in Jones that he will lend him a further £1,000 without any security. What is the effect of this?

For the time being it has enabled Jones to put into circulation another £1,000—it has given Jones a further £1,000 worth of purchasing power. This increase in Jones' purchasing power is known as *credit*.¹ Bankers are continually advancing credit to

¹ "Credit involves getting something now and paying for it later." Moulton, *Financial Organization of Society*.

business men to enable them to finance commercial enterprises. At times, when business is very flourishing in any country, when prices are rising and business men are making large profits, bankers are disposed to lend purchasing power more freely—to grant more credit. When business is bad and financial losses are being made by business men, bankers will not generally lend so much—credit is contracted, and purchasing power reduced.

From this it will be realized that the purchasing power of a community is elastic : it can be expanded or contracted by the banker who grants credit. Our previous notions of currency and its functions have therefore to be enlarged, for credit, which enables more cheques to be drawn, has the same effect as an increase in the quantity of coins and notes in circulation.

In essence, as we have shown, the economic system is much the same to-day as it was a hundred years ago, except that we are exchanging ten thousand times more commodities and using more currency (including cheques) to settle the debts arising from this buying and selling. In the meantime, however, the banks have become so powerful that it is possible for them to issue more credit—and therefore more purchasing power—according to the dictates of industrial requirements.

Suppose that in this country we had 100,000 articles ready to be bought and sold, and that we had £100,000 worth of currency in circulation to buy them. If nothing happened to alter this ratio, in the long run, by a process of competition of buyers and sellers, we might suppose each article to fetch £1. Now if we

assume that by some method the amount of money is increased to £200,000, but that the number of articles is not, buyers in competition with one another for the purchase of the goods, will be prepared to offer more money, and prices will rise and we should expect each article ultimately to fetch £2. The net effect, if this state of affairs were confined to one country, would be that people would be no worse off than before; but although the country had twice as much money, this money would only purchase the same amount of commodities as before.

This is only another way of stating an economic law, known as the *quantity theory of money*; if the quantity of money increases, commodities remaining constant, prices will tend to increase in direct proportion to the increase of money, the value of each unit of money falling in proportion to the increase of money. (N.B.—The value of money is determined by the quantity of goods it will buy. In the above example £1, after the increase in the quantity of money in circulation, will not buy so many goods as before; the value of money has fallen.)

It should be clear to the student at this point that anything that is done to increase the money side of the equation will tend to increase prices. The ways in which the money side of the equation may be increased should be considered. The Mint could turn out more coins, the Bank of England more notes, the banks could issue more credit; but the arbitrary increase of coins and notes, as the student will realize from the study of later chapters, is generally

prevented by Acts of Parliament in all countries. Governments, in times of difficulty, can pay their debts by issuing Treasury notes which people are compelled to accept in payment of debts. Such a proceeding is equivalent to a tax on all the members of a community, even though it stimulates production and enterprise for a while on account of prices rising and business men anticipating greater profits. Banks, too, can increase the purchasing power of a community by lending more credit; but this process is even more strictly limited than the actions of a government. *Monetary inflation* only occurs when there is "an increase in the aggregate of the elements constituting the immediate available purchasing power of a community, not accompanied by a proportionate increase in the total supply of available goods and services continuously at the disposal of the community". In times of war governments have vastly increased the purchasing power of their countries whilst commodities were not increased in the same proportions: shells, guns, and instruments of destruction are produced instead of all kinds of machinery, textiles, furniture—useful and enduring articles. Hence it follows that during a war the money side of our equation is increased, while the commodity side remains constant, or is even reduced by the destruction of capital.

PROBLEMS AND EXERCISES

1. Give an account of the economic functions performed by the Bankers' Clearing House and describe the organization by which it is carried on.
2. Give a short account of the currency of Great Britain. What part of the currency is legal tender ?
3. Outline the main points of the Mint Law relating to our system of coinage.
4. To what extent is it true that modern business dispenses with the use of money ?
5. Give an account of the qualities which go to make good money.
6. What do you mean by the value of money ? Can you suggest any commodity which does not vary in value ? How would you suggest that prices can be stabilized ? (Tabular standard.)
7. Refer to any book on banking and write an account of the early note issues of England.
8. What is credit ? Of what use is credit to the economic system and how can it be utilized by a business man ?
9. Does a banker create credit ? What are the dangers of the credit system ?
10. Do you think it advisable that the currency of the country should be a fixed amount of bills, notes, cheques, and coin ?
11. Compare the merits of cheques, bills of exchange, bank notes, and coin as media of exchange.
12. In what ways can a cheque be protected from fraud ? Give a careful description of the exact effect of the methods you suggest.
13. Give examples of the way in which the word " value " is used and show the necessity of exact thought when using this word.
14. Why can a country issue more notes during a war than ordinarily without depreciating its currency ? What is the only effective safeguard against the depreciation of notes ? What are some of the evils of note depreciation ?
15. What are some of the factors affecting the price of (a) wheat, (b) beef, and (c) a Paris gown ?

16. Why do you think men and women through the ages have desired gold and silver and other metals? What is the great advantage from the point of view of the consumer in having gold or silver as the basis of a currency?

17. What is meant by the "quantity theory of money"?

18. What determines the level of prices in a country? What do you understand by monetary inflation? Mention some of the evils of inflation.

19. How can purchasing power be vastly increased in modern times? In what ways can the cost of living be reduced?

20. Is our monetary system necessarily permanent? What is the whole foundation of the idea of standard money? Which concerns us most: the number of grains of gold in £1 worth of standard gold, or the purchasing power of £1?

21. Does the quantity of money in circulation matter to us? How did the discovery of silver in Mexico in the sixteenth century, and the discovery of gold in California (1848) and Australia (1851) affect prices?

22. Distinguish between the price and the value of gold. Does the value of gold affect its production? How would you measure the value of a bank note?

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CHAPTER VII

BANKING

Banking systems had their origin in remote antiquity. The steppe-dwellers of the near east knew the importance of merely being able to count their herds of cattle and flocks of sheep. Money was sought after because it was the commodity which represented universal purchasing power. Merchants began to specialize in handling money and, by their power to distinguish between good and bad currency, could assist traders and make a charge for their services. Their first function was probably to change one currency for another, and ensure that the trader obtained good currency. The next step was the establishing of such faith in the integrity of bankers that they were able to undertake the task of guarding the money of their customers and issuing receipts for it. Money changing is always necessary for foreign trade, and the modern system of banking may be said to date from the establishment of the Bank of Venice in 1157 for the purpose of changing money and buying and selling bills of exchange. The next important European bank to be set up was the Bank of Genoa, which began operations in 1407. The trade of the world was centred in the Mediterranean Sea.

With the discovery of America in 1492 and the subsequent transfer of world trade to the countries bordering the Atlantic Ocean, banks were started in other countries of Europe. The Bank of Amsterdam (1609) was in many ways a model of good banking organization, and like the Bank of Hamburg (1619) facilitated trade with foreign countries. They assisted commerce "not by loans, but by the local manufacture of an international currency".

A state bank, the Banco di Rialto, was established in Venice by Acts of the Venetian senate in 1584 and 1587. This was possibly the first public bank in Europe. The Bank of Sweden, founded in 1656, was the first public bank of the modern type. It was the first bank in Europe to issue bank notes (1658).

In England, as we have said, banking functions were carried on by the Goldsmiths in the sixteenth century. The goldsmiths of London had a monopoly of the purchase and sale of bullion, and of the storage of gold and silver coins. They paid interest to their depositors at 6 per cent. and charged enormous rates for loans of capital. It is interesting to note that the goldsmiths' receipts circulated among merchants much as bank notes circulate to-day. The system of banking in England has, however, been so influenced by the Bank of England, and the Acts of Parliament which regulate the working of the Bank of England, that we must describe the origin of the bank before dealing with later developments.

THE BANK OF ENGLAND.

In 1694, William Montague, the Whig Chancellor of the Exchequer, persuaded a group of capitalists, with Wm. Paterson at their head, to advance to the government the sum of £1,200,000 on the security of the State at 8 per cent. interest. The lenders received in return a charter creating them "the Governor and Company of the Bank of England". Money was needed at the time to enable William III to carry on the war against France, and although it was feared that the city merchants subscribing this money would become too powerful, and end by controlling parliament and the king, the dread of invasion by the French enabled the incorporation of the bank to take place. The Bank of England was given the right "to trade solely in bills of exchange, bullion, and forfeited pledges". The government also empowered the bank to issue notes: a new currency. For the student of our economic system the founding of the Bank of England is important because our National Debt was formed at that time. We call this debt a "funded debt", because the government did not promise to pay back the sum borrowed. Once the advantages of this means of borrowing money were recognized by the government the system was bound to develop. The new currency which was introduced was required on account of the increase of trade, and the bank note was firmly established in Europe.

The early pre-eminence of the Bank of England has been maintained throughout the two and a half

centuries of its existence. It was the banker of the government, the liability of its shareholders was limited, it was privileged to issue notes that were legal tender, it was the banker of the other banks and for long controlled far larger deposits than any individual bank.

After 1700 and throughout the eighteenth century private banking developed rapidly all over England. Growth was necessary, as we have already explained, owing to the expansion of trade and industry. Many of the private banks were allowed to issue notes, and the result was disastrous. Failures took place through the over-issue of notes and unsound management. The cost of producing notes was low, and the profit to be earned great. Manufacturers urged the banks continually to lend them capital for their growing trade. After the Napoleonic wars one financial crisis was followed by another. The government was compelled to take action after the crises of 1826 and 1839, and in 1844 the Bank Charter Act was passed. It was generally agreed that the Bank was an institute of a semi-public kind, and that the note-issuing department benefited the whole country. By the Act of 1844 the Issue Department was separated from the Banking Department. The issue of notes to the value of £14,000,000 was based on the credit of the government, and beyond this sum notes were to be covered by holding gold in reserve. The issue based on credit was known as the "fiduciary issue", and rested on the good faith of the government. When any other bank lost its right to issue notes the Bank was

allowed to issue two-thirds of the amount which lapsed. Thus if a country bank issued £3,000,000. in notes, the Bank of England could increase its fiduciary issue by £2,000,000 in the event of the country bank relinquishing its right of issue. Country banks which opened an office within 65 miles of London lost their right to issue notes ; no new banks of issue were allowed by the Act in any part of England ; and as a result of the necessity of all banks eventually having a branch in London the fiduciary issue has gradually increased until on 12th February, 1923, it had reached the sum of £19,750,000.

A further provision of the Act of 1844 was that a person could demand notes from the Issue Department in exchange for gold bullion at a price of £3 17s. 9d. per ounce, i.e. gold and notes were to be interchangeable.

The growth of banking was retarded by an Act of 1707 which forbade more than six persons from issuing promissory notes, and so prevented any bank being formed with more than six partners. In the year 1826 this prohibition was modified, and in 1833 it was removed. But there was still no limitation of the liability of bank shareholders, and up to 1862 every shareholder was liable to the extent of his whole means in the event of the failure of the bank. Practically all the joint-stock banks took advantage of facilities allowed under the Companies Act of 1879, except those formed under a special charter or Act. The note-issues of these banks were still a first charge, with unlimited liability, on the total assets of the

joint-stock banks. But the issue of notes had ceased to be the main source of revenue of the banks by 1840; the cheque system, which had been invented in 1698, came into general use and deposit banking had already become the most profitable part of the banker's business.

The effect of the Bank Charter Act of 1844 was to give the Bank of England control over the financial system of the country. In addition to possessing monopoly power in issuing notes, it became, by reason of its privileged position, the banking house of the other banks. It maintained the only effective reserve of gold, and other banks had deposits at the Bank of England and borrowed from it. By raising or lowering the *Bank Rate* the Bank of England is able to control the supply of loans and credit. It is the final arbiter because the other banks must at times have recourse to the bank holding the only considerable cash reserve. The Bank Rate is the rate at which first class bills of exchange are discounted by the Bank of England, and this determines the rate of interest given and charged by the banks and financial houses to their customers.

On account of the skill with which our banking operations are conducted, London is the money centre of the world.¹

In spite of the enormous growth of capital in the United States the position of London has not yet been

¹ "London, in spite of the immense sacrifices made by Great Britain in the War, has regained effectually its solid international pre-eminence in the world." Winston Churchill, April, 1929.

seriously assailed,¹ and the development of joint-stock banks in the United Kingdom with a large number of branches in every centre has been a source of great financial strength. The five big banks in Great Britain to-day control a far greater amount of credit than the Bank of England. Reference to the Bank of England weekly return and the balance sheets of the five big banks will convince the student of the strength of the British banking system.

The Organization of the Bank of England.—The Bank of England is a limited company whose capital is in the hands of shareholders who are similar in legal status to the shareholders of any ordinary company. The Governor, Deputy-Governor, and Directors are business men of high standing in the city, recruited chiefly from accepting houses and merchant banking houses. A Court of Directors controls the organization of the Bank, and it is an unwritten law that no Governor of the Bank shall be connected with another banking concern. The Bank Court is able to take an impartial view in financial operations involving the banking system as a whole.

Every Thursday a return is issued by the Governors of the Bank. This is published on Friday in most of the daily newspapers, and gives the financial position of the Bank on the day of publication. It also gives the key to the monetary situation in the country. The Bank Returns should now be studied. The first

¹ In the last ten years the total net tonnage of shipping entering the port of London has increased 200 per cent. In 1928 the total tonnage entered was 55,424,000.

BANKING

101

THE BANK OF ENGLAND RETURN

I

21st NOVEMBER, 1928

Issue Department

| £ | | £ | |
|-------------------------|---------------------|---------------------------|---------------------|
| Notes issued— | | Government debt . . | 11,015,100 |
| In circulation . . | 180,964,085 | Other securities . . | 8,734,900 |
| In banking department . | | Amount of fiduciary issue | 19,750,000 |
| | | Gold coin and bullion . | 161,214,085 |
| | <u>£180,964,085</u> | | <u>£180,964,085</u> |

Banking Department

| £ | | £ | |
|---------------------------|---------------------|---------------------------|---------------------|
| Capital | 14,553,000 | Government securities . . | 48,340,327 |
| Reserve | 8,204,147 | Other securities | 34,757,491 |
| Public Deposits | 14,898,189 | | |
| Other deposits | 99,472,105 | Notes | 48,161,710 |
| Seven day and other bills | 2,591 | Gold and silver coin . . | 870,504 |
| | <u>£182,180,032</u> | | <u>£182,180,032</u> |

II

15th MAY, 1929

Issue Department

| £ | | £ | |
|-------------------------|---------------------|-----------------------------|---------------------|
| Notes issued— | | Government debt | 11,015,100 |
| In circulation . . | 362,810,877 | Other Government securities | 236,210,945 |
| In banking department . | 58,329,310 | Other securities | 7,951,539 |
| | | Silver coin | 4,822,415 |
| | | Amount of fiduciary issue | 260,000,000 |
| | | Gold coin and bullion . . | 161,140,187 |
| | <u>£421,140,187</u> | | <u>£421,140,187</u> |

Banking Department

| £ | | £ | |
|---------------------------|---------------------|---------------------------|---------------------|
| Capital | 14,553,000 | Government securities . . | 37,816,855 |
| Reserve | 8,200,958 | Other securities— | |
| Public deposits | 9,290,798 | Discounts & advances | £9,586,015 |
| Other deposits— | | Securities | 17,746,941 |
| Bankers | £61,070,863 | | |
| Other | | Notes | 27,332,956 |
| accounts | 36,078,600 | Gold and silver coin . . | 58,329,310 |
| | <u>97,149,463</u> | | 720,781 |
| Seven day and other bills | 5,633 | | |
| | <u>£124,199,852</u> | | <u>£124,199,852</u> |

(Public deposits include Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts)

is dated 21st November, 1928, the week before the Currency and Bank Notes Act of 1928 came into force,¹ and the second 15th May, 1929.

The issue department deals only with the issue of bank notes. On the left-hand side of the return the total amount of notes issued by the Bank is shown; on the right hand side the securities, coin and bullion, which cover this note issue. It will be seen that on 15th May, 1929, £421,140,187 of notes were either in circulation or in the banking department of the Bank of England. Against this issue of notes, the Bank held in its vaults silver coin to the value of £4,822,415, and gold coin and bullion to the value of £161,140,187. This is known as the metallic reserve, and is increased or diminished as notes are issued or withdrawn from circulation.

On the left-hand side of the Banking Department Return—which is in many ways similar to the Balance Sheet of any other banking establishment—is shown first the proprietors' capital: the amount subscribed by the stock-holders of the bank. It consists of stock and not shares, and is similar to the stock of any other joint-stock company. The *Rest*, amounting to £3,200,958, is a reserve fund built up from the accumulated profits of the bank, for, of course, the Bank of England makes profits like any other commercial concern. The *Rest* is not allowed to fall below

¹ This Act gave the Bank of England the control of the Treasury note issue, and fixed the new maximum issue of the Bank at £260,000,000. The first return issued under the new Act was on 28th November, 1928, and showed a total of notes issued of £419,000,000. This Act ended an extraordinary financial period.

£3,000,000. Public deposits represent the money and credit which the Bank owes to government departments, for government departments have accounts at the Bank of England. The sum of all credits standing in the books of the bank to government departments is possibly our best way of describing Public Deposits. The sum of £10 paid to the tax collector by a member of the public is ultimately paid into the public account of the Income Tax Authority at the Bank of England. It follows that the total of public deposits varies considerably at different periods of the year. The amount is increased by taxes received, and diminished by the sums paid out by the Government to subscribers to public loans, e.g. Consols, War Loans, etc.

Other Deposits.—These consist of the deposits of all the joint-stock and other banks, the accounts of large corporations, private accounts, and any other accounts which are not government accounts.

Seven Day and other Bills.—This represents a very insignificant item in the return. The seven-day bill was invented in the early eighteenth century to obviate robberies of coin and bullion from stage coaches. They are now used for the settlement of debts between countries where other means are not available.

Turning to the right-hand side of the Return of the Banking Department, we have a list of all those assets which the bank holds wherewith to meet its liabilities.

Government Securities.—The Bank, like other banks, makes a profit by lending credit, i.e. purchasing power. It lends largely to the Government, and in return receives securities such as Consols, Treasury Bills, Exchequer Bonds, Government Stock, etc. All these

items are included under the heading Government Securities.

Other Securities.—Apart from lending to the Government departments, the Bank of England also invests in all kinds of municipal and colonial undertakings. Under this heading will therefore be found all those securities on which the Bank has given advances, which are not of the nature of a loan to the Government.

Gold and Notes.—This item represents the amount of currency the bank holds in the form of coin and bank notes. The bank notes are convertible into coin by transferring them to the Issue Department, for they form part of the notes issued by that department.

The amount of gold and notes forms the Bank Reserve: the currency with which the bank could meet a sudden demand for cash. In practice there is a fairly constant ratio between this reserve and the public and other deposits, i.e. between the actual cash in hand and the immediate liabilities which the bank would have to meet in the event of a financial crisis. It is the ratio of the reserve to the liability which determines the Bank Rate (see next chapter).

From what has been said of the Bank of England certain conclusions may now be drawn as to its nature and functions :—

1. From the time of its inception to the present day it has been the most important institution in the country for the control of money and credit. Within the last quarter of a century its monopoly power has been challenged by the amalgamation of banks into the big five, which collectively control the greater part of the currency and credit of the nation.

2. The Bank of England, although it is the banking house of the government and of all the other banks, is not a government concern. It is a limited liability company controlled by stock-holders for the making of profit. So vital is its function in controlling the bank rate and consequently the finances of the country, that tradition has made its profit-earning function subsidiary to its larger function of acting as the bank of the whole nation.
3. By acting as the banker of the government and of all other banks it enables large payments to be made by the government to the public and vice-versa by means of book-keeping entries. It thus facilitates the cancellation of debts and helps trade.
4. It provides a convertible currency in the shape of bank notes, which are used instead of cash in places where cheques would not be accepted.
5. It keeps the gold reserve of the nation, and is in a position to control national credit. It acts thus as a stabilizer of industry and trade.

PROBLEMS AND EXERCISES

1. From the balance sheet of one of the large joint-stock banks work out the ratio of the capital of the proprietors to the deposits held. Find out the total deposits of the five large banks for the last year.
2. What are the three functions of any national bank? How do you account for the fact that before the Federal Reserve Board was established in the United States the banks had to suspend payment every seven years or so for a period?
3. Why is it important that the Bank of England should continue always to pay gold on demand?
4. How have banking reserves been invested in the past to obviate the necessity of sending gold from one country to another?
5. Give an account of the origin and functions of the Bank of England.

6. Analyze the balance sheet of one of the big joint-stock banks, and work out the percentage of each asset to the total assets of the company.

7. Give the seven principal functions of banks in early and modern times. Summarize the 39 different services offered by the large banks in the United Kingdom. (The Westminster Bank issues a summary of services free.)

8. What would happen if we had no central bank directing the discount policy of the country? Why is the Bank of England the final arbiter?

9. What is the most important function of the merchant bankers?

10. "The maintenance of effective competition among the banks in respect of the financial facilities supplied by them to industry is regarded as a matter of national importance" (Balfour Committee on Industry and Trade, Cmd. 3282, 1929). Why is this so regarded? What might be the results of the absence of effective competition?

11. What is meant by the statement that the Bank of England has "the only effective reserve" in the United Kingdom? Have not all the other banks large reserves?

12. Trace the rise of joint-stock banking in the United Kingdom.

13. What can you deduce from the following fact: In 1913 there were 6,000 bankruptcies in Great Britain, and in the depression of 1920 only 3,000?

14. Show how the Bank of England weekly return would be affected by:—

- (a) The purchase by the Bank of 10,000 oz. of gold.
- (b) The payment to his account by a customer of the Bank of the sum of £10,000.
- (c) The half-yearly payments of interest due on War Loan.
- (d) The granting of £10,000 credit by the Bank to a customer.
- (e) The borrowing of £10,000,000 by the Government.

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CHAPTER VIII
THE MECHANISM OF EXCHANGE
THE MONEY MARKET

We have considered the use of money and credit in facilitating exchange, and have sketched the history of banking and the work of the banker in buying and selling loanable capital. It remains for the student to look at the modern economic world around him and try to visualize the working of the complicated financial machine.

The student will observe certain facts that stand out clearly, and he should be in a position to appreciate the significance of these facts :—

1. A mass of capital of every conceivable kind exists in the form of factories, machines, steamships, railways, roads, power stations, and raw materials scattered all over the world. All this capital is useful for the making of more things which satisfy the wants of people. Of itself this capital is nothing but an inert mass of material ; but when this material is used by organizers, inventors, and workers, huge quantities of goods of all kinds are produced. When all this capital is being fully employed, when workers, organizers and directors are busy, the community experiences a period of prosperity. Optimism is in the air, and all classes are happier and more prosperous economically. When the factories and machines

are lying idle, when the stacks of raw material are unused, when people are no longer working in the factories, there is a period of trade depression. All classes are less happy and everyone is pessimistic.

The problem of business economics is how to ensure the continuance of the first condition.

2. The second fact the student will observe is that money and credit are convenient means or tokens representing the right of ownership to certain quantities of all this capital. The possession of money gives to the owner the power to purchase things: machinery, factories, timber, coal, etc., and to employ workers.

If industry and trade are to be prosperous certain people who have the ability to organize, invent, or use all this capital, must be able to command the use of it at the appropriate time; they must, in short, have the command of money and credit.

The organizations which put into circulation a supply of currency, or purchasing power, can therefore be of vital importance in assisting all classes of the community to get busy by organizing, utilizing, or working on, this vast mass of capital. Very rarely will the student see the economic machine working to its full capacity in any community, and he will ask the reason. It requires little effort to see that there is a direct connection between banks and financial organizations on the one hand, and the whole of the industrial and trading interests on the other.

3. In every community the student will see two types of people: producers and consumers.

Every human being is a consumer of some of the goods that are produced : he must have at least a minimum of food, clothing, and shelter to keep alive.

The wants of a community are not fixed ; they vary considerably from time to time for many reasons. In the northern hemisphere woollen clothing may be needed in winter, cotton clothing in summer. Wants are, of course, not effective unless they are supported by the ability and willingness to buy at a price (demand).

Again, people are continually being trained by means of advertisements and education to want new kinds of goods. The more people want the goods advertised, the more they will translate their wants into demand, with the result that industry strives to satisfy these wants.

In order that business activity shall develop, people must be persuaded to demand commodities, and industrial organizations must be able to command the control of money and credit in order to get the capital and labour together. We will now consider the ways in which the wheels of industry and trade are kept going by means of money and credit, and will examine what is technically known as the *Money Market*.

Money Market.—The student who looks at the column headed “ Money Market ” in the daily paper, must not imagine that there is any one place where money, in the form of coins and paper, is being bought and sold. The popular conception of a market is a *place* where goods are actually handled by dealers. This is not the case in the Money Market.

Money is not really bought and sold : it is *borrowed* and *lent* ; and the price people pay for the borrowing and lending is termed interest. It will be clear that if there are people willing to lend money, and others willing to borrow, we have an organization in some ways similar to the local market with which we are familiar. We have two groups of people, one group willing to "sell" purchasing power, and the other wanting to "buy" purchasing power. What happens in a local fish market when the fish dealers have too much fish on their hands, and there are only a few buyers ? The sellers, in competing one with another, offer to sell at a lower price, while the buyers pay the lowest price possible.

So in the Money Market, if there are more sellers than buyers, or more correctly, if there are more lenders than borrowers, the price of money, i.e. the rate of interest which a person will pay for the loan of it, falls. On the other hand, if for some reason there is a sudden demand for credit owing to a new demand on the part of the public or industrial interests, then the rate of interest will tend to rise.

The main points of difference, therefore, between the Money Market and any local Market with which we are familiar, is that in the case of the Money Market—

1. There are no actual goods handled ; all that is dealt with is certain rights to purchasing power represented by so much credit at the bankers.
2. These rights are borrowed or lent, and the price at which they are borrowed or lent is called the rate of interest.

3. There is no local spot where all this borrowing and lending takes place. It is carried on all over the world at one time
4. The Money Market in fact consists of all the borrowers and lenders throughout the financial world.

It follows, therefore, that at any one time there is a given Money Market Rate of Interest which varies very little all over the world. At any given time there are groups of people willing to lend money and credit. Such are the joint-stock banks, the Bank of England, accepting houses, etc. At the same time there are groups of people who want to borrow: the industrial and trading public, joint-stock companies, bill brokers, people who buy and sell bills of exchange (see page 113), merchants and shipping houses who want to pay for foreign goods.

All these competing interests fix the rate each day, so that the Money Market Rate is the rate of interest¹ which a business person must pay if he wants to borrow money or obtain credit. The Bank of England for the reasons we have already mentioned is the foundation stone of the whole structure, for it holds the nation's effective reserve and can influence all the other groups in the market. But the most prominent members of the market organization are without doubt the large joint-stock banks. With their 5,000 branches they are in touch with industrial and trade conditions throughout the country and abroad, receive millions of pounds sterling daily on deposit, and loan credit to those who can turn it to account. Trust and finance

¹ The term "discount" is used for the rate charged for short periods.

companies also form a large group assisting business undertakings of all kinds at home and abroad.

Bank Rate and Market Rate.—The Bank Rate as we have already explained in Chapter VII is the official minimum rate of discount at which the Bank of England will discount approved bills of exchange. We have shown how the Bank of England endeavours to maintain the ratio between its stock of gold (the reserve) and its immediate liabilities to the other banks, the government, and the public. If the Bank of England finds that its liabilities in the form of Government and other deposits are increasing at a greater rate than the reserve of gold, it takes steps to attract gold to the Bank. By raising the Bank Rate it tends to prevent the business world from borrowing (business men will not generally borrow if they have to pay a high rate of interest). The effect of raising the Bank Rate is therefore to prevent credit from expanding and still further widening the gap between the metallic currency and the circulating media of exchange. The student will see that the whole conception of the bank rate is based on the assumption that the circulating media of the country should have a certain proportion of gold backing to enable debts if necessary to be discharged in gold coins.

The economic effects of raising and lowering the bank rate are too complicated for a full discussion here. All that the student need note at this point is that in a broad sense an increase in the bank rate generally tends to limit borrowing throughout the country, to restrict the supply of credit against which

cheques may be drawn, and to prevent the supply of cheque currency increasing out of all proportion to the amount of gold coin and bullion in the country. In view, however, of the millions of pounds worth of debts that are cancelled daily by means of cheques the student may well ask how this state of affairs can be brought about since the amount of gold seems to be already negligible and only a small fraction of debts in any case could be settled by the use of gold. Later the student will learn that in times of financial stringency foreign debts have to be settled by the export of gold bullion, and that the amount of the reserve is an index of the financial stability of the country. Under ordinary circumstances bankers raise or lower the rate of interest they allow on deposits according as the bank rate rises or falls. Bill brokers and others do likewise, and the influence is therefore felt everywhere. The joint-stock banks are now so powerful that the raising of the bank rate may not influence them. It is only at certain periods when the Bank of England has a momentary control over a large part of public and other deposits that the movement of the bank rate also affects the rates of interest charged by the Money Market and therefore by the banks.

The Bill of Exchange.—The Bill of Exchange is one of the oldest forms of document for the discharge of debts. In the middle ages bills were well known in this country, though the first reference to them in the courts of law dates from 1603. Probably at first they were used for settling foreign debts, but they were

soon adapted for use in domestic transactions. In essence a bill is similar to a cheque, except that it is not necessarily drawn on a banker, and that it has to be accepted before it is of use. The bill of exchange was devised to avoid the sending of cash from one town to another to settle a debt.

We give below a specimen of an ordinary form of a bill of exchange :—

LONDON, 1st January, 1929.

£100

Three months after date pay to the order of Mr. J. Smith the sum of one hundred pounds for value received.

J. W. GREEN & Co.

To Messrs. Brown & Sons, Liverpool.

Accepted by Messrs. Brown & Sons, Liverpool, 1st Jan 1929.

Let us assume that Brown and Sons, Liverpool, owe J. W. Green and Company the sum of £100. J. W. Green and Company draw this order, or bill of exchange, on their customers, Brown and Sons, Liverpool, who accept it, i.e. agree to pay the bill when it falls due. They do this by writing their names across the face of the bill. The bill above is drawn in favour of Mr. J. Smith, and can be sent by Messrs. Green and Co. to Mr. J. Smith in settlement of their account with him.

No man, of course, is bound to take a bill of exchange in settlement of a debt, but bills have been found so convenient in the settlement of indebtedness that they can be bought and sold at any time up to the date of maturity, i.e. the date when Brown and Sons must pay the hundred pounds. The actual value of the bill

will naturally depend on the financial status of Brown and Sons. If instead of Brown and Sons the acceptor should be a banker, it is known as a first class bill because there is no fear of its being dishonoured, i.e. not paid at maturity. Hence bills of exchange are graded into classes.

Certain people known as bill brokers trade in these documents. If a merchant in London wants to settle a debt in China, he can purchase from a bill broker a bill which has been accepted by someone in China and is due to be paid somewhere in China. If £100—or its equivalent—is owing by a firm to another in Hong-Kong, the firm can buy a bill on Hong-Kong, a bill that is due to be paid in that town.

Bill brokers need large sums of money in order to buy bills at certain periods; they borrow this money from the banks, or from the Bank of England. Their borrowings are known as day to day loans, i.e. they can be recalled by the banks at any moment. These loans are a source of great profit to the banks, while the brokers make their profits by buying and selling bills.

*Reading the Money Market Columns.*¹—The following is an extract from the money market column of *The Times* of 16th May, 1929:

The discount market yesterday was again under the influence of the New York exchange. For the greater part of the day the rate remained at about $\$4.85\frac{1}{16}$, and only rallied from this point late in the afternoon.

¹ To be studied in conjunction with the chapter on International trade.

Leading brokers generally quoted $5\frac{1}{8}$ per cent. as their working rate for three months' fine bank bills, and the Eastern banks sold bills to the market at this rate. Sales were reported at $5\frac{1}{16}$ per cent., and also at $5\frac{3}{32}$ per cent. . . . Money continued in keen demand for the greater part of the day, $5\frac{1}{4}$ – $5\frac{1}{2}$ per cent. being the general range in the morning for new day-to-day advances, while old loans from lenders other than the clearing banks were again renewed at 5 per cent. In the afternoon the position became a little easier, probably as a result of the disbursement of about £3,700,000 (net) in dividends on Treasury Bonds, etc. The Bank rate is $5\frac{1}{2}$ per cent., to which it was raised from $4\frac{1}{2}$ per cent. on February 7. The banks' deposit rate is $3\frac{1}{2}$ per cent., and the deposit rates of the discount houses are $3\frac{1}{2}$ per cent. at call and $3\frac{3}{4}$ per cent. at notice.

| Loans (per cent) | | Discount (Bank Bills) (per cent). | | | |
|---------------------------------|--------------------|-----------------------------------|----------------|----------------|----------------|
| Day to day | For short periods. | 60 days | 3 months | 4 months | 6 months |
| $4\frac{1}{4}$ – $5\frac{1}{4}$ | $4\frac{1}{4}$ –5 | $5\frac{1}{8}$ | $5\frac{1}{8}$ | $5\frac{3}{8}$ | $5\frac{3}{8}$ |

| Discount (Treasury Bills). | | (Fine Trade Bills) | | |
|----------------------------|-------------------|--------------------|-------------------|-------------------|
| 2 months. per cent | 3 months per cent | 3 months | 4 months | 6 months |
| $5\frac{1}{8}$ | $5\frac{1}{8}$ | $5\frac{1}{2}$ –6 | $5\frac{1}{2}$ –6 | 6– $6\frac{1}{2}$ |

FOREIGN EXCHANGES

During the earlier hours the New York exchange had a rather weak appearance, and there was evidence of a fairly widespread demand for dollars from

Continental centres. . . . After New York opened in the afternoon, however, offers of dollars came forward from that centre with the result that the rate rose slightly and finished at $\$4.85\frac{1}{8}$ A feature in the late dealings was a sharp decline in the Berlin rate, marks being keenly bid for. The final quotation was $20.42\frac{1}{2}$ m. compared with $20.45\frac{1}{8}$ m. on Tuesday ; forward marks were more offered. The Montreal rate fell from $\$4.87\frac{1}{8}$, but towards the close Canadian dollars were offered, and the final quotation was $\$4.88\frac{3}{8}$. There was a further decline in the French exchange, which closed at $124.13\frac{1}{2}$ f., and at 34.94 b. the Belgian exchange also moved against sterling. Swiss francs appreciated, the Berne rate moving to $25.18\frac{3}{4}$ f. After the Madrid rate had risen to 34.27 p., pesetas were bid for, and it closed at 34.11 p. Among South American exchanges the Buenos Aires rate was slightly easier at $47\frac{1}{8}\frac{1}{4}$ d.

The following table gives the range of telegraphic exchange quotations within which business was reported yesterday :—

| Place | Method of Quoting. | Par of Exchange | 15th May. | 14th May. |
|----------|--------------------|---------------------|----------------------------------------|---------------------------------------|
| New York | . \$ to £ | 4.86 $\frac{3}{8}$ | 4 85 $\frac{1}{8}$ —4 85 $\frac{1}{2}$ | 4 85 $\frac{1}{8}$ —85 $\frac{1}{8}$ |
| Montreal | . \$ to £ | 4 86 $\frac{3}{8}$ | 4 87 $\frac{1}{2}$ —88 $\frac{3}{8}$ | 4 87 $\frac{1}{2}$ —88 $\frac{1}{2}$ |
| Paris | . Fr to £ | 124 21 | 124 11—124 15 | 124 12 $\frac{1}{2}$ —20 |
| Brussels | . Bel. to £ | 35 00 | 34 93 $\frac{1}{2}$ —94 $\frac{1}{2}$ | 34 93 $\frac{1}{2}$ —94 $\frac{1}{2}$ |
| Berne | . Fr to £ | 25 22 $\frac{1}{2}$ | 25 18—25 19 $\frac{1}{2}$ | 25 19—25 19 $\frac{1}{2}$ |
| Madrid . | . Pts. to £ | 25 22 $\frac{1}{2}$ | 34 10—34 27 | 34 00—34 12 |

We have seen how the supply of bills arises. Bills on London are drawn against goods and securities and

also against the services rendered to foreigners by people in Great Britain. These bills are bought and sold in foreign countries and sent to London where they are turned into cash by the bill brokers and discount companies, who thus perform a similar function to the intermediaries on other markets. The principal buyers of bills are the big banks, who are anxious to make profitable use of their surplus monies. The banks in view of expected changes in the rates of discount may not wish to buy bills maturing several months ahead, and the brokers and discount houses left with a large supply of bills may have to go to the Bank of England.

The price paid for bills therefore depends as with other commodities on supply and demand. The demand is necessarily elastic as bankers can usually find outlets for their resources either in industry or on the stock exchange. When rates of discount are relatively high in London, i e. when bills of exchange can be purchased cheaply, foreign bankers are keen buyers of London bills.

One of the functions of the Bank of England is to safeguard the national reserve of gold. The raising of the bank rate tends to affect rates of exchange between this country and others. It makes it profitable for foreign bankers to invest in London bills. Business men, industrialists, and stock exchange dealers have to pay more for the money they borrow from bankers. The higher rate of interest offered on sums left on deposit attracts people to leave their money with the banks. So the money market is adjusted to protect

the gold reserve and the exchanges. If the regulation of the discount rates were left entirely to the reactions of supply and demand violent fluctuations might occur. A very heavy supply of bills on London might send the exchanges down below gold point, and cause considerable dislocation of international trade before the rates could be adjusted.

The Foreign Exchanges.—Buyers and sellers of foreign exchange are engaged in a very hazardous enterprise. Rates of exchange at which business is done in different countries vary from hour to hour, but owing to the use of the telegraph and telephone they tend to correspond at any particular time. The figures quoted from *The Times* above give the range of prices of foreign currencies for the day, the limits at which they were brought and sold; other newspapers like the *Financial Times* give the actual buying and selling prices. Obviously exchange dealers have to buy exchange at a lower price than they are prepared to sell it. The difference in the price at which they are disposed to buy and sell is their source of profit and is comparable with the “turn of the market” in the Stock Exchange quotation of the jobber.

PROBLEMS AND EXERCISES

1. Why is it difficult to give a general definition of Banking which will be true throughout the world? What is the essential feature of British banking business?

2. Give four reasons why there are more bills drawn on London from abroad than vice-versa.

3. What is used as international currency? Of what does the English bullion market consist? What is the annual yield of the gold mines of the world. (Consult an encyclopædia in the local library.)

4. Why is the production of gold important to the banking houses? What suggestions have been made for using an international currency?

5. In what countries of the world is silver used as the standard metal?

6. How does the amount of gold per head in the United States compare with the amount in Great Britain?

7. How are the many types of standard money maintained in the United States?

8. Estimate the importance of the following factors influencing the rate of exchange between one country and another: (a) external indebtedness, (b) stock-exchange transactions, (c) banking influences, (d) finance bills.

9. To what is foreign exchange due? In what directions are facilities for remittance between countries growing? Why were there exchange rates between London and Edinburgh in the eighteenth century?

10. Who is affected by a higher bank rate, and how? What are the effects of a high bank rate?

11. What do you mean by the bank rate and market rate? How does the bank rate affect the market rate? How does the bill broker make a profit? How do bill brokers assist commerce?

12. Does the money market exist at any one place? If not, why do we speak of it as a market?

13. Is there at any one time a uniform rate of interest throughout the world?

14. Draw up a foreign bill of exchange for £105. Describe its utility in commerce, the exact functions and liabilities of the parties to the bill, and trace its probable journey from the day it is drawn to the day it is met.

15. Explain the meaning of the following extracts from *The Times* :—

(a) "It was feared that an advance in the New York rediscount rate to 6 per cent. would react adversely upon

the sterling-dollar exchange. Discount rates were accordingly advanced further, the leading houses quoting $5\frac{5}{8}$ - $5\frac{3}{4}$ per cent."

(b) "Canadian dollars were cheaper."

(c) "Following the purchase of a small amount of gold in the London market for Germany, the rate rose sharply and closed at 20.37 $\frac{1}{2}$ m."

(d) "Forward dollars were again rather offered, especially for 3 months, on which the discount was $\frac{1}{8}$ c."

(e) "There was a further appreciation of French francs (124.10 fr.) but on the other hand, the Dutch rate moved in favour of sterling."

(f) "Spanish pesetas were weaker."

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CHAPTER IX

THE DISTRIBUTION OF GOODS

MARKETING

Reference was made in Chapter I to the direct contact between producer and consumer in primitive society. The work of production is not completed when goods have been grown by the farmer or made by the manufacturer. Goods have to be collected and transported to the spot where they are to be consumed. Often they have to be warehoused for a time until they are required, and generally for the convenience of the small consumer they must be divided up into units of pounds, yards, or dozens. With the growth of population and the advance of mass production in concentrated areas a number of intermediaries, or middlemen, have appeared who help to move goods from the original source of supply to the consumer. Some of these middlemen stand directly between the producer and consumer, others, like railway companies, insurance companies, and banks, perform services for all modern specialized business undertakings.

The growth of the functions of middlemen in the last century is thus a concomitant of the specialization of industrial processes. Whereas in early times the

manufacturer of clothing obtained his raw material (wool) locally, and spun and wove it into cloth which he sold to his neighbour in the village, to-day the demand for clothing is so great and so varied—and the process of specialization so advanced—that between the producer of wool in Australia or cotton in the United States of America, and the consumer in England, there may be as many as fifteen or twenty intermediaries through whose hands the raw material passes before it is sold in the form of the finished article ready for wear.

The student of business economics will realize at once that in spite of the abuse which is levelled at the middleman, his function has to be performed. There is no way of escape in modern economic production. The tendency may be in some cases, as we have already hinted, for the manufacturer and consumer to take over the functions mentioned in the first paragraph of this chapter. If they do so, they will have to bear the cost themselves; and they may be unable to handle the goods and carry them in time and space as cheaply as the so-called middleman. The student should always keep in mind the fact that the middleman continues the process of the producer. The shoes that have been made in a factory 100 miles away from us cannot supply our need until they have been brought to the place where we live. The shoe manufacturer may have his wares conveyed directly to us; but usually he makes use of the services of a number of specialists for this part of the process of production. He may sell his output of shoes to a firm of wholesale shoe dealers,

who in turn send shoes as required to retail shops. And the retail shops, or stores, sell the shoes again to the people who will actually wear them.

The first middlemen in the medieval villages and towns no doubt bought up local supplies and exhibited them for sale to their fellow townsmen. The function of the retailer is still the same to-day as formerly, except that instead of having one or two small shops selling a variety of local products, the retailer is sometimes housed in a palatial building and sells wares collected from all parts of the world.

The function of the retailer is to satisfy the immediate wants of the consumer. The consumer's wants in modern society are very varied and irregular. They vary with the weather, the seasons, the state of industry, the change of fashions, etc. The consumer as a rule knows little of the technical properties of the goods he buys, and is often ignorant of the qualities and types of goods that are for sale. The retailer performs the following services :—

1. He finds customers (or consumers) for the manufacturer and farmer.
2. He displays to the public a wide variety of merchandize collected from a wide area.
3. He satisfies the consumer's wants more exactly than the manufacturer might be able to do if purchases were made direct from the factory.
4. He sells small quantities, and bears the cost of warehousing goods until they are required.

The farmer possessing a poultry run could sell his eggs direct to the consumer if he wished ; but it would

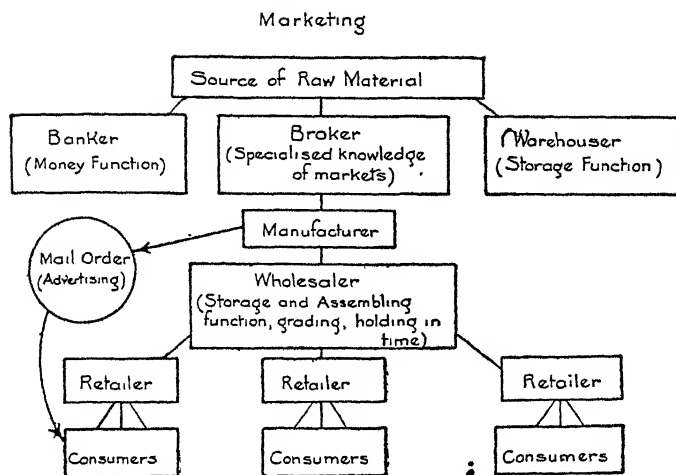
be difficult for him to find out the price individual customers would be willing to pay and the quantities they would regularly take at a given price. He would have the additional trouble of packing small parcels of eggs, despatching them, and collecting the sums of money due for them. Another method he could adopt of disposing of his eggs would be to take them to the retailers of eggs in the nearest town. But these retailers might not know how many eggs were required by people in larger cities, nor how to find customers there. The farmer would probably find it more profitable to sell all his eggs to a person in the larger town and leave to him the problem of finding customers for them. This wholesaler would probably grade the eggs according to their quality, keep them in cold storage if they were not immediately required, and sell them to bakers, grocery stores, restaurants, hotels, and dairymen. If he were in business on a very large scale he might employ his own travellers to search for customers among the retailers and restaurant keepers. The student will discover on making inquiries that large numbers of eggs in his local grocery store have been imported from countries like Denmark, and he will find that they have reached the retailer through one of the channels described. Of course, in spite of the organization we have outlined, eggs will continue to be sold by the farmer direct to the consumer.

The ideal of the farmer, or of the manufacturer, is to produce large quantities of goods at regular intervals, and each prefers to sell his merchandize through a very limited number of channels. The more standardized

the article, the greater quantity the manufacturer can turn out in a given time at a given cost. The wholesaler bridges the gap between the large-scale producer and the retailer, and by storing merchandize until it is required performs a useful economic function. Of course, all the persons we have mentioned may store the goods for a time: the producer, the wholesaler, the retailer and consumer—even the housewife usually has a small store of necessary household commodities. But seasons of production do not always coincide with seasons of consumption. Wheat is produced at harvest time, but is consumed all the year round. Storing, warehousing, and transporting are important functions in the handling and distributing of produce.

As soon as it becomes possible to draw supplies from the whole world and to sell finished goods to the whole world, the element of distance is a factor which has to be considered in the distribution of goods, together with the factors connected with the use of foreign currencies, and the increased risks that are necessarily involved when goods have to be sent thousands of miles across land and sea. Railway and shipping companies, bankers, insurers, warehousemen, and brokers are all concerned in facilitating the movement of produce and manufactured goods to the point where they are ultimately going to be consumed.

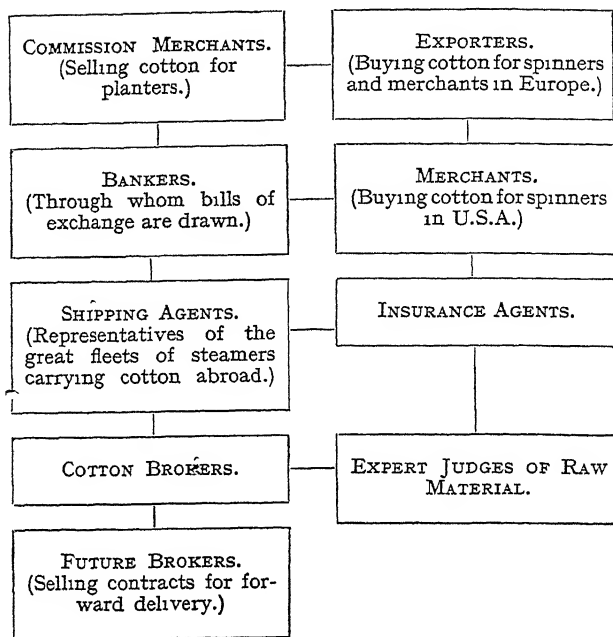
We are now in a position to visualize the specialized business units co-operating in the process of distributing produce and merchandize :—



Now let us attempt to visualize a diagram representing the middlemen engaged in handling a product imported from abroad and of universal consumption—Cotton.

The Report of the American Industrial Commission, No. 11, 27, gives a list of the merchants represented on a cotton exchange.

In addition to these nine separate groups of persons who are concerned with the handling of the raw material in the country in which it is produced, we have in England on the Liverpool Cotton Exchange similar groups of middlemen, serving the needs of the business units engaged in the different processes of manufacture.



The buyer of products that can be graded and standardized knows just what he is buying from their description. Abuses have crept into the organizations in many cases, and governments have had to assume control of standards and appoint inspectors to examine the goods to ensure that standards are maintained.

This process of the separation of producer from consumer and the interpolation of an increasing number of middlemen was the characteristic feature of

distribution throughout the nineteenth century. There is now, as we have already stated, a very definite tendency in the reverse direction. Producer and consumer are being brought into closer contact by the elimination of middlemen. We find examples of this tendency in :—

1. The Mail Order business.
2. Vertical combination.
3. The amalgamation of retail stores.
4. The multiple shop. (The chain store.)

(1) *The Mail Order Business*.—This is a method of bringing the manufacturer into direct touch with the customer by advertisement in the daily, weekly, or monthly journals, or by circular through the post. It has developed considerably during the last decade, and is very suitable for articles of consumption which can be easily graded, or illustrated.¹ Hence the method is used for the sale of such things as gramophones, garden implements, certain articles of wearing apparel, etc. In view of the fact that it eliminates the function of display and grading, it may not be so satisfactory a method of distribution for many articles of consumption as through a retailer. Inasmuch as the method concentrates the attention of the potential purchaser on one article without involving the trouble of visiting a store and spending an hour or more in making a selection, it saves time and energy. The method, if it is more widely adopted, may inflict losses on wholesalers and retailers in smaller

¹ The Sears-Roebuck mail-order catalogue contains over 100,000 separate items.

towns¹; but our economic organization must always be ready to adapt itself to better, or more economic, modes of distribution which enable goods to be sold to the consumer at a cheaper rate.

(2) *Vertical Combination*.—In Chapter V we showed how manufacturing firms have increased in size and absorbed other businesses which in the first instance supplied the raw material to them. The United States Steel Corporation is a good example of a vertical combine. As a result of this vast organization the services of many middlemen were dispensed with in the iron and steel and subsidiary trades.

(3) *The Amalgamation of Retail Stores*.—In the last decade the process of amalgamation of retail stores has also tended to reduce the number of wholesalers. Goods are purchased in such large quantities that the buyers of the store can obtain their merchandize direct from the manufacturers on the same terms as the wholesaler.

(4) *The Multiple Shop (The Chain Store)*.—Since the War we have seen a striking development in this country and the United States in the multiple shop. Chains of stores under one organization have been opened in different towns up and down the country. Two hundred such stores were opened in 1928 by one company² in the United States, and it is estimated that 1,300 more will be opened during the next six years. In the United Kingdom companies like Lipton's

¹ The profits of wholesalers and retailers go to printers, newspaper proprietors, or the Post Office.

² Montgomery, Ward & Company—a mail order house.

and the Maypole Dairy Company have hundreds of shops throughout the country, and can buy in many cases such enormous quantities that they control the sources of supply.

PROBLEMS AND EXERCISES

1. Which is generally larger : the unit of production, or the unit of marketing ? Why ?
2. " Under this scheme supplies shall be made only to the representatives of the Irish Importers' Association, whose members deal with over 97 per cent. of the coal imported by Ireland " (*The Times*). Estimate the effects of such a co-operative scheme of marketing the five million tons of coal exported from the United Kingdom to Ireland (a) in eliminating unnecessary competition, and (b) in securing a stable price.
3. " The market for goods sold for wholesale consumption ordinarily is clearly defined and of narrow scope in comparison with the market for goods sold at retail." Explain this statement fully and its implications. Contrast the market for raw cotton and the market for handkerchiefs.
4. Outline the various problems facing the shoe manufacturer in the marketing of his shoes. What choices of sale has he ?
5. What part do consumers' buying motives and habits, convenience, custom, play in determining the success of a retail store ? Illustrate your answer with reference to groceries, and articles of women's dress.
6. Why is there a tendency for more and more articles to be sold in packages in the retail store ? How are middlemen affected by such tendencies ?
7. What advantages has the departmental store over the unit store ? Are the operating expenses of the store likely to be less than those of the one-man shop ?

8. "A co-operative store, properly speaking, is one that is owned and managed by consumers." Explain this statement.

9. "In the larger cities, the supply of produce from nearby sources is so inadequate for the total needs of the community that large quantities must be shipped in from more or less distant points." Does this account for the presence of a large body of merchants in such a city as London? Why?

10. What are the main functions of a wholesaler? What risks does the wholesaler have to bear? Does the wholesaler have any influence on production?

11. Mention some of the advantages to a manufacturer of being able to sell his entire output to, say, 50 wholesalers? Illustrate your answer by reference to the sale of shoes.

12. "The co-operative movement (for selling Empire fruits) was therefore started with a membership of 9,000 Jamaica growers and the company purchased four ships of 8,000 tons each, and the first of these arrived in the Thames on 7th May, 1929." What may be the results of such an improvement in the marketing of Empire fruits? "The fruit was in splendid condition and it was all sold before arrival." How could the fruit be sold before arrival? Who would purchase such fruit, and how would it be distributed?

13. The provision of adequate terminal facilities was an important factor in the success of the above experiment. Give examples of world products and discuss the arrangements for the handling of cargoes. Are they adequate in all cases? Why not?

14. "In solving marketing problems, it is only sound business policy to consider carefully how the general interests of the public may best be served." Discuss the ultimate effect of policies which do not consider public interests.

15. In what great trades is the auction method adopted in marketing? Where are these auctions situated, and why? What advantages has the system of auctioning raw materials?

16. How is a continuous supply of fresh meat to the retail shops provided for in your locality? What is done to prevent the wastage of an excessive supply?

17. What are the three tests of a good marketing method? Why does the consumer hold the key to the problem of

marketing? How can the manufacturer sometimes "determine what the consumer shall want?"

18. Why is it important that the consumer should be given every opportunity of choosing his goods wisely?

19. A retail shopkeeper's books show that he had £4,123 of goods at the beginning of the year, and £3,700 at the end of the year. His sales (less losses and bad debts) amounted to £12,130. His purchases of merchandize amounted to £8,700. He had to pay carriage on his goods of £254, and gave cash discounts of £214. His total expenses were £2,456. What was his gross profit, his net profit? If his capital amounted to £5,000, what dividend per cent. could he pay?

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CHAPTER X

MARKETING

Auxiliary Services to the Marketing of Produce.—

From what has been said of the distribution of world produce, the following facts are evident :—

- (a) Raw materials are being drawn from wider and wider sources ; the whole world is being exploited in the service of science and industry.
- (b) Manufactures are increasing in quantity and complexity ; the enormous variety of new types of manufactured goods is the result of scientific and industrial research.
- (c) The market for manufactured goods is becoming larger and larger : natives in all parts of the world are being trained to demand the manufactured goods of civilization.
- (d) With the operation of these forces, certain auxiliary services have become increasingly important—these are banking and finance, insurance, transport, warehousing. The controllers of these services, while not directly engaged in buying and selling goods, provide facilities for the carrying on of economic enterprise at all stages of production and distribution.

In the course of the long journey which raw produce takes in passing to the consumer, there are necessarily a number of points at which the produce changes ownership (see diagrams on pages 127, 180, 181). In

between these points certain services operate to facilitate the flow of goods.

Banking and Finance.—The service rendered by the banker to the business community has already been considered in detail in Chapters VI and VII. At almost every point the banker assists commerce and industry by granting credit. By his help the manufacturer and exporter are enabled to produce goods in anticipation of demand. The exporter can obtain cash for his consignment of goods the very day he ships them abroad. The banker discounts for him a documentary draft. But for this facility the exporter would have to wait for his money until the goods had reached their destination, or had been sold.

Insurance.—We have shown how the community depends for the most part on individual enterprise and initiative to obtain its supplies of food and goods. Risks of all kinds are inherent in the making and moving of merchandize. Some arise from natural causes, like fire and death, or accident. Others are due to changes in fashion, or methods. Now insurance is a device for reducing the risks of the business man, particularly his capital risks. Insurance against the risks of fire, although suggested as early as 1635 in England, was not undertaken until 1667—one year after the great fire. Companies estimate the capital losses that may arise from various causes—fire, accident, death, etc., and on the basis of the calculations made, they undertake to bear the risk for business men on payment of an annual sum, called a *premium*. The companies know that if they take small

sums from a large number of business men, they will be able from the total sum collected to make good losses that actually occur, and a profit for themselves in addition.

This risk-bearing function becomes more important the greater the number of business transactions. The lack of insurance might cause serious dislocation of trade. If the factory that has been destroyed by fire cannot immediately be replaced by the owner, he and his employees may suffer want. The following are some of the commercial risks undertaken by insurance houses :—

1. Fire.
2. Accident.
3. Life. The loss of capital on the death of a partner may be serious for the business.
4. Loss of profits.
5. Fidelity Guarantee.
6. Floods.
7. Burglary.
8. Sickness.
9. Employers' Liability.

The above are only a few of the risks that the business man has to face ; but the possibility of insurance against these unforeseen contingencies make him more willing to undertake his other risks. With the advancement of knowledge risks are still further lessened. Government departments issue crop reports, the consular service is in close touch with the trend of business in foreign countries, trade journals and associations disseminate knowledge of conditions in markets, commercial agencies report on the financial condition of the customers of a business man.

Information of all kinds is more easily obtained, and is available for the use of all.

The larger industries have to some extent been able to dispense with the help of insurance houses. They are able to spend vast sums in research ; investigate their own markets, estimate future demands, and study the conditions affecting production of their products. Men of science are also rapidly being absorbed by business undertakings. Radio is lessening the risk of loss at sea ; automatic sprinklers diminish the risk of disastrous fires in large ware-houses ; mechanical safety devices and signals lessen risks of transport by railways ; and science generally is working in the interests of the whole community.

Lloyds.—Lloyd's had its origin in gatherings of business men for gossip in the coffee house of Edward Lloyd in Tower Street, London. Mentioned first in the *London Gazette* of 1688—six years before the foundation of the Bank of England—it has since become one of the greatest British business institutions. Shortly after moving to Lombard Street in 1692, Mr. Lloyd issued a weekly paper giving commercial information and shipping news. This was a matter of extreme difficulty in the days before the invention of the telegraph and telephone. *Lloyd's News* was the forerunner of the famous *Lloyd's List*, the second oldest newspaper, which continues to give the movements of shipping, etc., obtained from agencies and signal stations all over the world. By 1774 the association of its members had become closer and its headquarters were moved to the Royal Exchange. Printed forms

for marine insurance were introduced and adopted generally by members in 1779. The interesting thing is that this form remains in use still, although slight modifications have been made. In 1871 Lloyd's was incorporated with three main objects :—

- (a) The carrying out of the business of marine insurance.
- (b) The protection of the interests of its members ; and
- (c) The collection and publication of shipping intelligence.

In its corporate capacity Lloyd's does not undertake the business of insurance ; this work is done by its members, who, before they are elected to membership, have to satisfy the committee that their means are adequate, and deposit a large sum as a guarantee. Members of Lloyd's to-day will accept almost any risk on sea, on land, or in the air. *Lloyd's Register of British and Foreign Shipping* gives a classified list of the ships of the world in regard to their seaworthiness. A1¹ is the highest class, and the premiums for insuring vessels so classified, and the goods they carry, are lower than those charged for ships classed as 90 A1, or 80 A1.

The method of affecting insurance is simple. The brokers at Lloyd's prepare slips of paper naming the ship, the shipmaster, the voyage, the subject to be insured and the total value. Each underwriter puts his name against the amount he is prepared to underwrite (insure) and as soon as the total value is reached the insurance is completed.

¹ Hulls are classified alphabetically, A, B, C, etc., and equipment numerically, 1, 2, 3, etc.

Transport.—So vast are the economic problems connected with transport that we have space only to summarize the more important economic aspects of an improvement in transport services :—

- (a) *Distance is overcome.* The wider the area over which goods pass, the greater the need of efficient transport.
- (b) *Wealth is created.* Improved transport has enormously increased the sum total of wealth within the last century. Wheat in central Canada is not wealth until it can be transported to places where it is consumed. Transport brings into the sphere of the world's wants a greater supply of commodities.
- (c) *Transport increases population.* By increasing the potential wealth of a community, a larger population can be supported.
- (d) *Transport brings into commerce a greater variety of commodities.* The student has only to compare his diet to-day with that of a student in the Middle Ages.
- (e) *Improved transport promotes the division of labour.*
- (f) *The market is widened.* A larger number of buyers and sellers is brought into contact.
- (g) *The world is linked into an economic whole.* This should tend towards a better understanding.
- (h) *Consumers are benefited.* Better transport means cheaper goods.

The modes of transport through the ages form a fascinating study, and in the different countries of the world the student will still see examples of each type. In the trackless wastes of Africa, loads are still carried on the heads of natives ; horses and mules carry burdens over bad roads and tracks ; rivers and

canals are used by the smaller boats and barges ; steel rails carry loads at great speed ; giant ships carry hundreds of tons on a single voyage ; huge motor lorries can make use of arterial roads ; aeroplanes can make the journey to India and back with light loads within a fortnight.

Railways v. Canals.—With the growth of railways in the last century canals have become less important in Great Britain and the United States. In many European countries canals are still much used and are enabled to compete with the railways by means of preferential rates. In Great Britain the canals have been deliberately sacrificed to the railways. The barges used are too small, and through traffic with the larger barges is impeded. Electrically driven canal transport may help to revive the lost traffic.

Railways v. Roads.—The advantages of road transport have been thrown into prominence by the building of arterial roads during the last ten years. Along these roads near London industries are growing apace, and new industrial areas are being formed. In many cases it is cheaper and quicker to distribute goods, or obtain raw materials, by road than to use the railways. Heavy goods in large quantities can, however, still be sent long distances at a cheaper rate by rail. The development of specialization in the making of small parts of finished products by companies widely separated tends to favour the use of road transport. These parts can be assembled in factories near the large towns. The arterial roads are also opening up land which is offered at low rates for

factory development. A redistribution of industry may result from the construction of better roads.

Warehousing.—With specialization in the function of storage, merchants are no longer concerned with the problem of housing goods at a port until they are shipped, or of storing the goods unloaded from a vessel. Warehouses adapted for the storage and protection of all kinds of merchandize have been built in places where they are needed. Modern methods of warehousing are bringing a much greater quantity and variety of produce to consumers in all parts of the world. Commodities which were formerly considered perishable can now be transported and warehoused without loss. This all tends to assure a steady and wide range of food products to an increasing number of people. In all the large docks throughout the world the equipment for warehousing is now as vital as the steamships or locomotives themselves. The shipping port must have its grain elevators, oil storage tanks, cold storage warehouses, etc. The means available at the London Docks for unloading carcasses of mutton at the rate of 70,000 an hour is only an element in the rapid and hygienic handling and storage of world products.

The Post Office.—The function of the post office is all-important. The mediaeval merchant could not convey information rapidly. It was uneconomic to send a personal message by one's own servant unless the transaction involved was of considerable magnitude. The post office system organized the carriage of private letters at a fixed rate, and the carriage of small wares.

A regular and certain service was set up in England in 1638, and from these beginnings developed a speedy means of spreading information, for the first advertisement was inserted in an English newspaper some twenty years later. The nineteenth century saw the invention of the telegraph and telephone instrument, and these also were placed under the control of the state through the post office organization.

The Post Office Guide gives full information of the services provided by the Post Office and should be studied by the student of business economics.

PROBLEMS AND EXERCISES

1. Are risks increased in modern business owing to the process of specialization? Why?
2. Production is now carried on in anticipation of demand. How are the risks of business enterprise increased by this method of production?
3. Modern economic organization is undergoing rapid changes to-day. Why is insurance necessary to spread the risks involved in these changes? If the reorganization of business renders old capital useless, is it true to say that capital has been destroyed?
4. If you owned a shop in a flourishing industrial district and the factories around you closed, would your business be affected? What would be the effect on the banks, railways, and other services?
5. Why is business more speculative to-day than in the middle ages in England? How has this state of affairs been brought about?
6. Name all the transport agencies you can think of from the local carrier to the Imperial Airways air-liner.

7. What special advantage lies in sending a small parcel by Parcels Post? Why can the Post Office take your parcel from London to Aberdeen for the same payment as from one district in London to another? Mention some of the services that are conducted by the Post Office. (Look up the Post Office Guide)

8. What special services to commerce are performed by—

- (a) The Empire Marketing Board, and
- (b) The Department of Overseas Trade.

9. How do bonded warehouses assist traders?

10. Why is a contract of insurance necessarily one in which the utmost good faith is required on the part of the person insuring?

11. Why does a premium for fire insurance often vary according to the locality, the nature of the thing insured, its position, etc.?

12. What are the "common warranties" in connection with the conveyance of goods by sea?

13. Obtain a copy of a Bill of Lading. Read it through, and then write down what you think is the purpose of the document.

14. What is a Charter Party?

15. Find out the objects of the Merchant Shipping Act of 1894.

16. Why do you think it is necessary for every person affecting an insurance to have "an insurable interest"?

17. Why are roads classified? Why has every citizen the right to use the roads without let or hindrance? How should this right be exercised in modern times? What is the guiding principle in imposing speed limits?

18. What kind of market has a railway company? How do the railway companies keep in touch with the people who use the railways?

19. The capital expenditure of the railways in the United Kingdom is more than £1,100,000,000, and on subsidiary undertakings about £150,000,000. Why is it in the interests of the whole community that the capital owned by these companies should be fully used?

20. Why is it important to know the amount of the principal commodities that are carried by the railways of a country?

21. What business does a ship broker do ?
22. What is the principle underlying insurance at Lloyds ?
23. Say what is meant by Employers' Liability Insurance, Fidelity Guarantee Insurance, Partnership Mutual Life Insurance, and explain the utility of each.
24. What are the four main factors that determine the localization of industry ? Why do transport facilities tend to dominate the other factors ?

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CHAPTER XI

THE GROWTH OF WORLD MARKETS

In order to understand the organization and growth of world markets it is first necessary to obtain a clear conception of the meaning of *market* as used in modern business economics.

The past century has seen an unprecedented expansion of markets. This is due to :—

1. Improved methods of transportation ; canals, roads, the application of steam and the internal combustion engine
2. Telegraphic and telephonic communication.
3. The spread of education throughout the world.

The early period of colonization with the regulated companies touched the coastlines of continents only. The interiors of continents were opened up during the last century by the agencies referred to above. North and South America, Africa, Australia, China, and Japan—all have developed economically during the last 100 years as never before in the history of the world in so short a period. The total population of the world has increased to undreamt-of proportions and the spread of education through this population has resulted in the rapid expansion of wants and the ability to satisfy them. It is too early yet to say whether the limits of expansion have been reached, for science plays an important part in increasing the

productive capacity of the world. The search for new markets is keener to-day than ever before; new ways have to be found of selling goods and training salesmen, and adding to the attractiveness of products.

A market in ordinary language is a place where goods are sold to the public. In point of time the market was originally the village green or public meeting place where merchants from the surrounding districts brought their goods for sale to the people of the locality. These markets still survive to-day in almost every town of Europe; but the quantity of goods sold in them is small relative to the purchases and sales through what are called *world markets*. A *local market* is only suitable for goods which are obtained locally and can be easily transported to the market; fresh vegetables, flowers, fruit, dairy produce, poultry, eggs, bulk largely in the items sold and bought in local markets to-day.

With the improved methods of transport already mentioned markets have become during the last 150 years national and international. Even before the era of rail transport there were national and international fairs at such places as Stourbridge, Winchester, Nijni-Novgorod, Bruges, and Venice.

The essential feature of a local market is that the produce is sold in the open market, and prices are known to all. Owing to the linking up of world resources, improved communications and the grading of produce, the local market has given way to *world markets* in which the produce of the whole world is

bought and sold by sample and description. Let us take the example of the market in wheat. Right up to the middle of the nineteenth century there were many wheat markets all over the world; even in England before the eighteenth century the price of wheat varied considerably from one part of the country to another. To-day, however, there is a world market for wheat and for all the staple raw materials such as cotton, wool, tobacco, flax, coal, iron, etc. By "world market" we mean that the produce of the whole world is available for potential buyers. As a result of the telegraph and the rapid dissemination of news from hour to hour, it follows that prices of a standard quality of wheat will be the same all over the world subject to a slight adjustment for the cost of transport. A market in the economic sense is not necessarily a place, but is a collection of buyers and sellers in close contact with one another, whose actions fix a world price at any one time. In order that a commodity shall become the subject of a world market it is necessary that the commodity be in universal demand, capable of being exactly described, be transportable, and of value in proportion to its bulk. An article of food like potatoes would not, therefore, form a suitable commodity for a world market as potatoes are not of great value in relation to their bulk, and they quickly deteriorate. It should be noted that methods of cold storage and improved transport have brought into the world market commodities which were formerly of local value only. Specially constructed steamers bring fruit to these

islands from the West Indies; frozen and chilled meat from New Zealand and the Argentine. Improved organization thus enables producers to grow or make the products for which the region is best adapted and increased productivity is the result. Through a world market we reap the benefit of territorial specialization.

The Purchase and Sale of Commodities in a World Market.—Goods are sold in a world market by sample, or by description. Where it is not possible accurately to grade the different qualities of the product, it is sold by sample, e.g. grain, pulses, timber, etc. A sample of any one of these commodities may be presumed to represent the whole, and the buyer may expect that the whole quantity when delivered will be equal in quality to the sample submitted. Manufactured goods of uniform type are also suitable for sale by this method. Modern science has discovered ways of grading practically every commodity, with the result that it is possible to buy more and more goods in the world market merely by description.

A glance at the financial columns of a newspaper will show the student that world markets exist also for the sale of stocks, shares, bonds, and other securities, as well as for the commodities that are essential to man's existence, and must be obtained by a community no matter what the cost of transport may be, or how great the distance.

The existence of a world market brings home to us the all-pervading influence of price. The buyer of such a product as wheat is indifferent as to the person who supplies it, and if he is asked a lower price for the

same grade of wheat he will at once purchase his supplies from the man offering the product at the lower price. This principle was called by Jevons the *Law of Indifference*: in the same open market at the same time there cannot be two prices for the same commodity. The tendency operates everywhere; but we have already shown that perfect competition rarely exists, although publicity, knowledge concerning crops and supplies and cost of transport, the extensive demand and supply, all tend to make the principle or law operate and fix one price for the same commodity at one time.

Sale by Auction at Certain Centres.—In many commodities there have developed centres throughout the world where a great part of the purchases and sales of that commodity take place. At these centres the chief buyers congregate to bid against one another as the produce is put up for sale by an auctioneer, i.e. a person who is authorized to sell goods or property at a public auction for a commission. The diagram showing the list of persons represented on the cotton exchange (p. 128) should be referred to. The brokers operating on such a produce exchange are buying and selling cotton on commission. They do not have possession of the cotton they sell, nor do they sell on their own account.¹ World sales are carried on in the following goods at the places mentioned¹:—

| | |
|--------|-------------------------------------------------------|
| Wool | . London, Melbourne, Amsterdam |
| Cotton | . New York, New Orleans, Liverpool, Bombay. |
| Grain | . Chicago, London, Liverpool, Buenos Ayres, Winnipeg. |
| Meat | . Chicago, London. |

¹ See Dowling, *The Exchanges of London*.

The Economic Effect of Speculation.—It has already been stated that the demand for a commodity and the supply of that commodity ultimately determine the price of it. In commerce future supplies as well as future demands also affect price determination. Thus the price of wool to-day is fixed *firstly* by the present demand for wool in the mills in Yorkshire and elsewhere, and the prospects of the industry in demanding more or less wool in the future. If it is felt that there will be a falling off in the demand for woollen clothing in six months, this anticipated demand will affect present prices. *Secondly*, it is fixed by the supply of wool available for sale, plus the quantity of wool which is likely to be forthcoming in the future. If the wool clip in Australia promises to be a good one, and wool is likely to be plentiful, then prices will tend to fall now in view of the anticipated supply.

| |
|----------------------------------|
| SUPPLY <i>plus</i> FUTURE SUPPLY |
|----------------------------------|

| |
|-------|
| PRICE |
|-------|

| |
|----------------------------------|
| DEMAND <i>plus</i> FUTURE DEMAND |
|----------------------------------|

In all the staple commodities it is possible to buy forward, that is to buy "futures": produce not yet in existence. Because commodities can in most

cases be finely graded, there is little risk of the buyer not getting the quality he requires in the future.

Hedging.—A manufacturer of cotton goods buys futures in order to avoid the risk of losing money through a fall in future prices of cotton. He knows that the price at which he sells his piece goods rises or falls with the price of his raw cotton. Suppose the manufacturer needs 1,000 bales of cotton for immediate use in his factory; but is afraid that prices of cotton will fall in two months. At the same time that he buys the 1,000 bales to keep his factory going he may sell through a cotton broker another 1,000 bales at the same price for delivery two months hence. At the end of the two months he buys the second 1,000 bales and makes delivery. When he comes to buy the second lot of 1,000 bales for actual delivery, if cotton prices have fallen in the intervening period, he will make a gain on the deal, for he had contracted to deliver at the higher price, and now can buy at the lower figure. But against this gain must be set the corresponding loss resulting from the lower prices he now obtains for his manufactured goods: handkerchiefs, piece goods, etc. If cotton prices rise, he will lose on his "future" and gain on his manufactured goods. This process, known as hedging, relieves him of anxiety regarding prices. He is not a gambler in the ordinary sense; he merely wants to free himself from the risks of price movement in the raw materials he uses.

The economic effect of buying "futures" is to increase existing demand. The buyer, in anticipating

a future rise in price, buys now and therefore increases present demand. Similarly, if he thinks prices will fall, he may sell a "future" and thereby increase the present potential supply. By thus bringing future supplies of commodities into a present speculation, he tends to stabilize prices—to prevent violent rises and falls in prices. This assumes that speculation is legitimate, and not carried on with a view purposely to raise or lower prices. If a group of financiers buy up the existing grain supplies with a view to raising prices in the future, speculation becomes harmful to the community, because it brings about violent alterations of price level.

PROBLEMS AND EXERCISES

1. "The produce markets to a great extent reflect the sentiment of the Stock Exchange and are themselves at every turn, the sources of influence operating upon it." Explain this interaction of world markets. (Read Chapter III.)

2. What is meant by a world market? What services have assisted in bringing about world markets? What would you say were the conditions of a perfect market from the point of view of the producer and the consumer?

3. Explain and comment on the following statements: "A mortgage bond is not property in itself. Its intrinsic value is only a few pence. It is, however, a title to share with others in the revenue of the property. . . . So, again, the share certificate is evidence of a title to a greater or lesser portion of the revenue of a given undertaking."

4. Suppose the undertaking is situated on the other side of the world, how is it possible for a person to become a shareholder in a business he may never see?

5. Trace the extension of the term "market" from the original meaning of "a meeting place" to its present economic meaning of any organization of buyers and sellers of a given commodity of food, money, labour, or manufactured article. How do you account for this extension of meaning?

6. What are the economic effects of good markets and marketing facilities?

7. What is the main object of trusts, cartels, groups, pools, etc.? How are these objects attained?

8. Why have the municipal retail markets in large cities not been very successful, while public terminal wholesale markets have been most effective?

9. What four influences govern price movements in wholesale markets? Why is the phrase "changes in supply and demand" vague? How does price adjust itself to supplies that are coming forward?

10. What three sets of reports has the dealer on the wholesale produce markets to consider? How should they be used?

11. Find out what government reports are available concerning the great food crops of the world. Why do attempts to corner such a food supply as wheat generally fail?

12. What sources of information are available to the buyer of cotton?

13. What is generally the basis of a standard in the grading of a product in the wholesale market? Look up the market report concerning wheat in your newspaper and make a list of the different kinds of wheat quoted.

14. Make a list of the kinds of cotton quoted in your newspaper and mark the sources from which raw cotton is drawn on a map of the world with the prices alongside. How do you account for the differences in price of the different kinds?

15. How do you think standards have come to be set in the markets of the world? Who sets up the standards? How might standardization be carried out?

16. Why is inspection of produce difficult?

17. Into what three groups are contracts in world markets divided? Distinguish between spot, floating, and delivery contracts. How can floating contracts be sub-divided? Explain what is meant by C.I.F. contracts. What is the difference between a C.I.F. contract and an arrival contract?

18. What are the usual terms of payment of a contract on the international markets of the world ?

19. What does speculation in futures tend to do to a market ?

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Marshall, A. *Industry and Trade*.

CHAPTER XII

INTERNATIONAL TRADE

General Nature of Foreign Trade.—Although the causes and advantages which attach to the internal trade of any country apply equally to its foreign trade, the following special features of foreign trade have to be noted:—

1. Foreign trade is affected by the obstacles of national boundaries.
2. Further hindrances are (*a*) differences of coinage, language, customs, habits, (*b*) distance, (*c*) a foreign legal system, and (*d*) differences in foreign business methods.
3. Geographical influences affect the exchange of products over wide areas.
4. Foreign trade involves the introduction of middlemen, who assist in overcoming these difficulties.

Foreign trade is an extension of territorial specialization. It is largely determined by "the conditions of comparative cost" in the trading countries: the relative conditions of production. "It is on the existence of differences between costs when compared in the trading countries that the possibility of any trade taking place depends. Where the proportional costs are the same, there is no motive for exchange, and it is by the amount of their difference that the benefit, and therefore to a great extent

the volume, of the transactions will be settled.”¹ The advantages to be derived from foreign trade are those resulting from specialization: people, nations, or groups of people, can specialize in those industries for which they may by reason of tradition, skill, or the possession of natural resources, claim greater advantages in production than other groups. It must not be forgotten that international trade is not the exchange of goods between one government and another, but between individual traders, and that the “impelling force of all exchange is the economic motive of self-interest”. Even if all countries were equally fitted to produce manufactured goods of every description, geographical influences would still dictate the main movements of trade. Cotton, rubber, cocoa, coffee, and other products will never be grown cheaply in the temperate regions. Latitude will always play a part and bring about a trade from south to north and vice-versa.

Foreign Trade in Early Times.—The lack of organized markets was the greatest impediment to foreign trade in mediaeval England. There were few good roads, tolls and taxes had to be paid on land and water routes, and the merchant had to protect himself and his belongings from robbery and violence on his journey with a convoy of caravans or baggage horses. He could not be certain when his goods reached their destination that they were wanted, or whether others had arrived just before with similar wares. Nor could he be certain that the coins he received in payment for his goods

¹ C. F. Bastable, *Commerce of Nations*, pp. 10–11.

were of the right weight and quality until he had weighed them or had had them assayed. On the high seas the navigator did not like to lose sight of land¹: navigation was in its infancy, pirates infested all the well-known sea routes, and the merchant was not averse from engaging in a little piracy himself if the opportunity offered.

Though the quantity of goods exchanged abroad by English merchants during the mediaeval period was small, and consisted largely of the import of luxuries of great value in proportion to their bulk, and the export of raw materials like wool, leather, and tin, the way was paved for further international co-operation. Italy was chiefly concerned with the carrying of spices, rich cloths, dyes, and precious stones to England and the Netherlands. The Hanse League of German merchants had its headquarters at the Steelyard, where Cannon Street station now stands. The Merchants of the Staple (cf. gilds) controlled the export of wool through certain fixed channels, buying their privilege from the king; and later the Merchant Adventurers monopolized the export trade in manufactured goods, and served probably as a model for the regulated companies (p. 63). We have already mentioned the work of the regulated companies and dealt with the organization of fairs, markets, and shops. The origin of fairs is still obscure. Religious festivals, which drew large numbers of people to a town and necessitated

¹ The Saracen's compass—a magnetized needle attached to a piece of wood which floated in a cup of water—was improved in the fourteenth and fifteenth centuries.

their being fed, seem to have brought about the establishment of some of them.¹ The needs of exchange led to their rapid growth during the twelfth, thirteenth, and fourteenth centuries, and many of the fairs in England were visited by foreigners. We can trace the beginnings of a system of commercial law to the customary fines for offences committed at these fairs. The "practice of the merchants" represented the "private international law of the Middle Ages". The meeting of Englishmen and foreigners no doubt helped to destroy the prejudice against strangers, and developed familiarity with notes and drafts of foreign origin. The early banking transactions also took place^o in these organized markets. The Church of England exerted a powerful economic influence in these early times. It was concerned with every phase of economic life. Goods were sold at a "just price"; usury, or the taking of interest, was a sin. But the church actively assisted trade and commerce, and fostered the arts of weaving, spinning, working in stone, etc.

The Spirit of Exploration.—The late fifteenth century witnessed the growth of a new spirit in English life: a strong interest in the life and peoples of other lands, a strong desire to explore new countries, a willingness to undergo hardships for the mere sake of adventure. The outlook of men was widened; they strove to win fortunes in foreign enterprises. To live a life of mere existence became intolerable to the finer spirits of

¹ St. Cuthbert's fair, Durham, was established before the Norman Conquest.

the time. Gold and silver came into the country in large quantities ; the last traces of serfdom were swept away ; mental activity was stimulated by the invention of printing with movable type. Old customs broke down at the coming of a new intellectual curiosity which had its origin in Italy and spread rapidly through the west. Even religious authority was questioned. A series of powerful kings, and the actions of a remarkable queen, unified the nation. Strong central governments were set up. Trade became safer and less difficult ; systems of weights and measures and the coinage were improved. The guilds declined in importance and modern economic life began.

We have sketched already the course of the development of the Industrial Revolution, and the growth of England's world commerce. With the discovery of America in 1492 England stepped into the forefront as the leader in international trade. Spain and Portugal and the Netherlands were her rivals at first. Her position at the centre of the newly discovered world, in which oceans were no longer hindrances but highways of trade, gave an impetus to England's economic development which is reflected in foreign trade returns. Day, in his *History of Commerce* (p. 205), gives the following estimates of England's foreign trade between 1700 and 1800.

| | |
|------|-------------|
| 1700 | £12,000,000 |
| 1750 | £20,000,000 |
| 1800 | £72,000,000 |

Up till 1870 England was almost " the workshop of the world ", turning out vast quantities of

manufactured goods and exporting them to all continents, receiving in return raw materials.

World Competition in Production after 1870.—Since 1870 the position has gradually been changing. America, Germany, Canada, the Argentine, Brazil, India, and the British colonies are all manufacturing on a large scale and consuming their raw materials. It would appear to be only a matter of time before all nations become sufficiently enlightened economically to compete with their manufactured goods in the markets of the world. The rapid spread of industrialism during the last fifty years is due to the dissemination of ideas, knowledge, inventions, the export of our machinery and the intermingling of peoples as a result of modern methods of transport and communication.

Analysis of Foreign Trade.—If all nations adopted the policy of free trade, each nation would eventually produce and export those goods in which it had a comparative advantage over other nations. Even without free trade, the comparative advantages of production will largely determine the nature of the merchandize which a nation will export ; while in the case of raw materials production is determined by the following :—

- (a) Climate and geographical influences.
- (b) The cost of labour in extracting raw materials.
- (c) Facilities for transport.
- (d) The extent to which scientific production has been introduced.

Climate, soil, topography will always give the

southern states of the United States, Egypt, and parts of India comparative advantages in the production of cotton. The rolling grass lands of Australia and the Argentine will retain their comparative advantages in the production of wool and meat. Geological distribution is the determining factor in the production of minerals and the precious metals. The forces affecting the distribution of raw materials of the kind mentioned are almost unalterable except over long periods of time; though the exhaustion of crop areas, and the development of new ones owing to transport agencies penetrating the interiors of continents, may in the course of time create new sources of supply. Similarly with minerals such as coal: mines may become too deep to be workable on an economic basis. These influences are, however, slow to operate, and we can assume that for some decades there will be a flow of wool, meat, and wheat from Australia, South America, and the United States to Europe; of cotton from the United States, Egypt, the Sudan, and India; of rice, oilseeds, cocoa, coffee, and rubber from the tropics.

Modern scientific discoveries have produced synthetically substitutes for raw materials which originally came from natural sources. Artificial silk is manufactured from wood pulp, synthetic and artificial rubber are produced by chemical processes, as are also building materials such as concrete, cement, etc. Chilean nitrate has been largely replaced by nitrogen fixation, though its production continues to increase. Chemistry begins to play a more important

part than geography, and labour supplies can be augmented everywhere by the use of machinery.

The influences affecting the world movement of manufactured goods are far more subtle and varied than those determining the production of raw materials. A country may possess a comparative advantage over another in producing particular manufactures by reason of one of the following factors :—

- (a) The cost of labour.
- (b) The degree of inherited skill in manufacture.
- (c) Facilities for transport.
- (d) The nearness of raw materials.
- (e) The influence of tariffs and duties.
- (f) The ability to buy and control new patents.
- (g) The effect of monopoly in keeping down competition.
- (h) Economic forces resulting from organized labour and capital co-operating more readily.
- (i) The introduction of new machinery, or new methods, which render existing plant obsolete.
- (j) The influence of advertising and salesmanship in capturing markets.

The analysis of the comparative advantages is too involved for adequate treatment in an elementary book of this kind, but the following examples may throw light on causes which are continually working to direct and re-shape world trade.

Coal.—Before 1914 British coal was in world demand, and formed a considerable part of the exports of Great Britain :—

Average exports of coal from 1905–14, 61·6 mill. tons.

Average exports of coal from 1919–28, 46·0 mill. tons.

During the last nine years our export of coal has seriously diminished owing partly to the transition from coal to oil fuel, and the use of hydro-electric power in

many countries. This transition was accelerated by the high price of coal. Mountainous regions, deficient in coal, are now becoming of first rate importance as manufacturing centres by reason of their possessing abundant water power. Switzerland, Sweden, and Canada will probably undergo rapid economic development for this reason. The discovery of a cheap process for extracting oil from coal would again bring British coal into its former important economic position. In a paper read recently at a meeting of the British Institute of Naval Architects, Mr. J. Johnson said that "high-pressure steam propulsion may be expected to occupy a predominant position in the future." Powdered coal may be largely used.

Cotton, and cotton goods.—Whilst England still retains her position as a producer of the highest quality of cotton goods, Japan, India, and the United States have become serious competitors in the last ten years. These nations have equipped themselves with up-to-date factories and machinery, have gradually acquired a supply of skilled labour, and have built up cotton industries behind tariff walls. In the spinning of high grades of cotton, British superiority is still marked.

Iron and steel —England has gradually lost her initial advantage as the first great producer of iron and steel goods. In 1870 Great Britain produced nearly 6,000,000 tons of pig-iron, and the United States 1,665,000 only. The producing capacity of the United States had been raised to 49,000,000 tons of pig-iron in 1926; while Great Britain's capacity was 12,000,000. The United States produced over one-half of the world's steel in 1926.

Many similar cases could be quoted to show how all civilized nations of the world are tending to reach a higher level of industrial production, owing to some of the influences we have indicated. The importance

of new inventions and the application of science to industry cannot be too strongly emphasized as factors in international trade. Methods of production may be revolutionized by new inventions in the near future.

The Influence of Legislation on Foreign Trade.— Governments exert considerable influence on the direction of foreign trade in the following ways :—

- (a) They impose customs and excise duties.
- (b) They regulate industry ; restrict hours of labour, conditions of employment, etc.
- (c) They give bounties to certain industries and trades.
- (d) They prohibit the import of certain commodities.
- (e) They insist on the maintenance of certain standards of quality.
- (f) They protect trade marks, etc.

Practically all industrial countries have imposed tariffs on imported goods in order to build up home industries. Many of the chief industries of Germany, Japan, and the United States have been built up in the last thirty years by a deliberate policy of protection, or the prohibition or limitation of imports in certain trades and industries. By this means they have encouraged certain industries to develop within the national boundaries. British goods have been shut out from many markets by this policy, or have been undersold in foreign markets on account of cheaper local labour and the lack of restrictive legislation in the foreign country. By means of bounties on sugar, the protectionist countries of Europe stimulated the export of sugar in the late nineteenth century, and

did serious damage to the cane sugar industry of the West Indies.

Arguments for and against free trade have aroused more heated controversy than any other branch of economics. Although space will not permit adequate treatment of the subject, it is thought that the following summary may be of help to the student in forming his ideas.

Arguments for Free Trade

1. Free international trade is a form of division of labour; any artificial barrier which interferes with the free flow of commodities tends to destroy the advantages of division of labour.
2. The choice of the industry to be protected often rests with a legislative body which is liable to be influenced by interested producers.
3. Once a duty is imposed, it is difficult to know when and how to withdraw it.
4. Exports are paid for by imports; if imports are reduced, exports will be reduced accordingly; hence protection merely transfers capital and labour from one group of industries to another—no net economic gain resulting.

Arguments for Protection

1. Protection by raising the prices of imported goods safeguards home industries—many infant industries need protection in order to get established; once established, the duty can be withdrawn.
2. Protection gives employment to home capital and labour, and increases the productive power of a nation, which in its turn re-acts on national efficiency.
3. Protection promotes diversity of employment by increasing the number of industries.
4. Protection lowers prices by increasing the output of home manufacturers.

5. Increase in wages will depend on the efficiency of labour—not on the price of goods; whilst profits may increase, wages seldom increase in the same ratio.
6. The history of British industries indicates that they were built up by a system of free trade. N.B.—This was during a period when England had few competitors.
7. If one industry is protected it is difficult to know where to stop.
5. Protection secures a steady home market; it is more difficult to gauge a world market.
6. Protection will increase wages.
7. Industries of foreign countries, e.g. Japan, U.S.A., and Germany have been built up on protection.

PROBLEMS AND EXERCISES

1. Contrast the coalfields of the United Kingdom with those of the United States under the headings of (a) extent, (b) condition, (c) the use of machinery, (d) accidents, and (e) the use of by-products.
2. What special advantage has the United States over the other great powers so far as her foreign trade is concerned?
3. What factors are operative in foreign trade that are not in domestic trade?
4. What is meant by the theory of comparative cost in foreign trade? How do the complications mentioned in the text affect this theory?
5. "Goods are never sent anywhere unless there is reasonable certainty that the inhabitants of the country to which they are sent will be able to pay for them in meal or in malt, in goods or in services" (Hartley Withers). To what extent does Great Britain pay for imported goods in services? How does the foreign seller expect to be paid?

6. What are tariffs? For what reasons are tariffs imposed? Who eventually pays the customs duties imposed on imported goods?

7. How are exports financed? What are the shipping documents used by exporters? How does the banker help the exporter? How have governments helped in recent times?

8. What are some of the immediate effects of a boom in trade? What effects has the reaction from a trade boom on the mind of business men?

9. What are some of the causes of fluctuations in trade? How can a business man discover when a boom in trade is approaching?

10. Why was mediaeval trade meagre? What special impediments were attached to foreign trade in early times? What parts of the modern organization were lacking?

11. Why did banking begin in Venice, Genoa, and Amsterdam? What were the functions of the banks in these cities?

12. Draw up a list of the economic functions performed by the merchant in early times and show how these are performed by specialized middlemen to-day.

13. Give examples of bounties offered by governments to stimulate foreign trade. (Look up the subject in a good encyclopædia.)

14. State all the arguments you know in favour of the protection of industries in a country against foreign competition. Which of these arguments are economic and which political?

15. What are the general benefits which a country derives from her foreign trade? Does a large foreign trade indicate national efficiency?

16. What is meant by "a favourable" balance of trade?

17. Is the foreign trade of a country necessarily an index of its prosperity? To what countries in the world is foreign trade more essential than others?

18. Compare and contrast the sea-borne traffic of the Atlantic with that of the Pacific.

19. What is "Entrepôt Trade"? Why has England lost much of her Entrepôt Trade in the last half century?

20. What types of cargo would you expect a vessel to be

carrying which passes through (a) the Panama, (b) the Suez Canals ? From what countries would these vessels be coming and what would be the destination of the cargoes ?

FURTHER READINGS AND REFERENCES

- Bastable, C. F. *The Commerce of Nations. The Theory of International Trade.*
Griffen. *Principles of Foreign Trade.*
Knowles, L. *Economic Development of the Overseas Empire.*
Cunningham. *Rise and Decline of the Free Trade Movement.*
Taussig. *International Trade.*

CHAPTER XIII

INTERNATIONAL TRADE

The Foreign Trade of Great Britain.—The foreign trade of Great Britain has reached enormous proportions as the published returns of the Board of Trade show. It is estimated that the resources of Great Britain are only sufficient to support a population of about twelve millions at the present standard of comfort. To feed the rest of the total population of 44 millions we are dependent on foodstuffs and other produce from abroad. Now if we have to import goods to provide for the wants of 32 millions of people, it follows that we must export in return raw materials or manufactured goods to pay for the imports, or else pay for them in cash. A moment's reflection will convince the student that imports have to be paid for. They are brought into the country by private initiative, and the owner of them has to be paid or he would not part with them. A person cannot pay out continuously in cash without replenishing his fund from earnings; nor can the persons making up a nation. In Great Britain the excess of imports over exports is paid for from the earnings of such services as shipping, banking, brokerage, and our investments overseas. These

services and commissions form what are called "Invisible Exports".¹ Before the war Great Britain owned nearly half the mercantile tonnage of the world. Our ships, therefore, earned money by carrying foreign goods (freight charges). Money received for such a service is equivalent to an export of goods to the same amount.

Similarly our banking system is of such renown that our bankers are able to earn commissions by discounting bills and financing the foreign trade of other countries. These earnings also are equivalent to exporting manufactured goods of like value. "We have a steady revenue from foreign investments of close on £300,000,000 a year, 90 per cent. of which is expressed in sterling, and rises or falls in value with the position of the sterling exchange. . . . These resources from overseas constitute the keystone in time of peace of our economic position, but they depend upon the stability and integrity with which our experienced democracy has hitherto been prepared, under every stress and strain, to maintain the strictest principles of public finance and public faith."

It is possible to construct a kind of Receipts and Payments Account for the Nation each year, and the following statements of 1927 and 1928 should be compared.

¹ "The income which we derive each year from commissions and services rendered to foreign countries is over £65,000,000."—Winston Churchill, 15th April, 1929.

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| INVISIBLE EXPORTS ¹ | 1928 | 1927 |
|--------------------------------------------------------------------|----------------------------|---------------------------|
| | £ | £ |
| Excess Government receipts from overseas | 13,000,000 | — |
| Net national shipping income | 130,000,000 | 140,000,000 |
| Net income from overseas investments | 285,000,000 | 270,000,000 |
| Net receipts, short interest, and commissions | 65,000,000 | 63,000,000 |
| Other net miscellaneous receipts | 15,000,000 | 15,000,000 |
| TOTAL INVISIBLE EXPORTS | 508,000,000 | 488,000,000 |
| <i>Deduct</i> —Excess imports of merchandise and bullion | 359,000,000 | 392,000,000 |
| NET TOTAL CREDIT BALANCE | <u>£149,000,000</u> | <u>£96,000,000</u> |

The student will gather from these statements that it is true to say that we pay for the goods we import largely by the manufacture and export of goods in return. As we must of necessity import large quantities of food and raw materials for our surplus population of 32 millions, we must manufacture goods to pay for them. If we ceased to import supplies of food, many millions would cease to exist at present standards of living. It is therefore imperative that Great Britain should maintain her export industries in order to support the present population. Unfortunately, since the War our exports have been reduced 20 per cent., while our imports—many of which consist of manufactured goods that might be made in this country—have increased by 20 per cent. The country is in the position of a person who is earning less and spending more. Yet Great Britain still retains “its solid international pre-eminence in the world” by reason of its great

¹ *The Times*, City Notes, 22nd February, 1929.

past, and the sure foundation on which its structure is built. The tables on the previous page show a surplus in spite of the immense sacrifices made by the country during the War.

THE ORGANIZATION OF THE IMPORT AND EXPORT TRADE

In overseas trade, as we have seen, the demand for middlemen to continue the process of production is necessarily greater than in home markets for the following reasons :

- (a) *The greater distance between the producer and the consumer.*—Transport and insurance are consequently more prominent factors than in home trade. Goods often have to be trans-shipped, and the removal from one form of conveyance to another must be supervised. In early times in England towns grew up in places where there was a break in transportation.
- (b) *Foreign customs.*—Goods have to cross national frontiers. The handling of goods at the "break" points is left to specialists : agents who can deal with difficulties on the spot, open packages for Customs inspection, etc. Hence the need of agents—forwarding agents, dock companies, ware-housers, etc.
- (c) *Foreign currencies.*—Differences in currency have from early times necessitated the help of specialists in exchange and international banking, bill brokers, foreign discount houses. All these agencies tend to break down the obstacle created by differences in currency.

- (d) *The uncertainty of markets*—Goods produced in large quantities in remote parts of the world are sent to certain “market” points for sale. Both prices and customers are uncertain. Market conditions are often unknown to producers. Export and import merchants handle the market supplies more efficiently than the producer, by reason of their special knowledge of local demand. Without the aid of these specialists it might be more difficult to find customers for foreign produce.
- (e) *Buying in bulk*.—As foreign produce and goods are often bought in great bulk, the total value of consignments is considerable. Expert knowledge is demanded; hence the origin of brokers, merchants, and buyers who deal in one commodity only.¹

The type and function of the middleman will depend on the nature of the foreign trade—whether import, export, or entrepôt, as well as on the type of produce handled. The organization dealing with food crops such as grain, sugar, cotton, etc., will be quite different from that concerned with the distribution of manufactured goods. The Reports on Marketing issued by the Ministry of Agriculture and Fisheries are admirable for the study of marketing methods both at home and abroad.

The Import Trade.—Methods of handling imported goods vary from one country to another, as do methods of financing the movement of these goods. For the convenience of study we have differentiated the various functions in importing raw produce into Great Britain. In practice these functions may not all be performed

¹ *Report on the Marketing of Wheat, Barley, and Oats*. H.M. Stationery Office, 6d. (1928). Chapter vi, pp. 61–80.

by separate groups of people. Many of the merchants who are said to be handling raw produce may not see the goods themselves, but only inspect samples.

Import of Raw Produce into Great Britain.—The following figures show the value of the chief imports into the United Kingdom during the years 1924-6.

| | | (Thousands of £ sterling ; c.i.f. figures) | | |
|---------------------------|---|-----------------------------------------------|-----------|-----------|
| Articles | | 1924 | 1925 | 1926 |
| TOTAL IMPORTS | . | 1,277,439 | 1,320,715 | 1,242,863 |
| Grain | . | 121,509 | 111,878 | 99,590 |
| Meat | . | 106,596 | 122,465 | 114,274 |
| Cotton | . | 75,104 | 125,581 | 84,310 |
| Wool | . | 52,143 | 76,033 | 65,762 |
| Oil seeds, fat, etc | . | 52,143 | 55,515 | 45,483 |
| Do. (partly manufactured) | . | 39,154 | 36,638 | 43,856 |
| Rubber | . | 9,655 | 29,744 | 33,516 |
| Wood, timber | . | 51,069 | 46,511 | 39,269 |
| Non-ferrous metals | . | 32,719 | 38,142 | 37,113 |
| Hides and skins | . | 21,243 | 21,808 | 19,556 |
| Leather | . | 14,389 | 15,078 | 14,089 |
| Tobacco | . | 17,377 | 17,097 | 17,725 |

Certain features of marketing these products are common to all of them, for all can be standardized, or graded.

1. The raw produce is consigned to an *Importer* in Great Britain. The firm or company importing the produce may be handling general produce, or specializing in one type only, such as timber. Many of these importing houses have years of experience, tradition, and knowledge behind them; and they have customers in this country through whom they can market the produce with which they deal. They

often control large warehouses at docks and riversides, and are in a position to handle the produce very expeditiously. They have, moreover, a special knowledge of the laws and regulations affecting the trade, and are in a position to overcome the obstacles we have outlined. The growth of these import houses is conditioned by :—

- (i) An established connection between foreign producers and manufacturers or consumers in this country.
- (ii) A special knowledge of the commodity.
- (iii) The control of the equipment necessary for the handling of commodities—warehouses, transport, etc.
- (iv) The ability and knowledge to finance the transactions involving the movement of the goods.
- (v) Exact information concerning customs duties, and the clearance of goods.

2. The importer of raw produce from abroad may rely on the services of a *Broker*—a specialist in the buying and selling of a commodity, who prepares the goods for sale by auction, or buys and sells on the produce exchange. On the exchange the produce has to be made ready for inspection, divided into lots, marks, or grades, and catalogues must be prepared to guide the prospective buyer. A warehouse company may do this work of preparing the produce for sale, or, in some cases, it may be done by the importer himself or the broker.

On a given advertised date the shipment is put up for sale by auction, and trade buyers will bid against one another for the purchase of the produce. The

price, as we have already learned, is ultimately determined by the demand for the produce and the supply which comes forward for sale at the time or in the future. The knowledge that large shipments are on the way may tend to depress prices.

3. When the goods have been sold by auction, the buyers will arrange for the transport of the goods from the docks to the points where the produce is to be manufactured, or passed to the wholesaler and the retailer. In some cases *forwarding agents* will be employed to deal with the transport of the produce of large shipments, or even smaller consignments where, as in Germany, state railways do not deal directly with the public. On the other hand the transport arrangements may be made by the buying house itself. Whoever attends to the transport of the goods is performing an important economic function, as we have already shown.

The documents used and the method of procedure will vary with each trade, the customs of the trade, the trade terms generally accepted, and the methods of making the calculations. Once, however, the general organization of importing has been grasped, the student should be able to handle intelligently the documents in connection with a particular trade. This is a question of business routine, and not of business economics. Arithmetical skill and care in the preparation of the documents of commerce are of fundamental importance.¹

¹ We have deliberately refrained from attempting to give the student a complete survey of the business routine connected with

In the case of manufactured goods imported into this country the procedure is much simpler than that described above for the importation of raw produce. Imported goods, partly or wholly manufactured, are generally consigned direct to an agent in this country who will sell either to a wholesaler, or a retailer, or direct to the public.

Entrepôt Trade.—The adoption of the scheme of bonded warehouses¹ in which goods that were liable to duty could be stored under the superintendence of the customs authorities until they were re-exported led to the growth of a large *entrepôt* trade in Great Britain. Joint-stock companies own most of the larger warehouses, and give "bonds" in large sums to the government as a pledge that the duty on the good will be paid if they pass into the country. The Customs Consolidation Act of 1876 and later Acts² govern the conduct of these warehouses, which are a boon to importers and exporters, as the payment of duty is postponed until the goods are required for home consumption, while the ownership of the goods can be transferred as readily as if the goods were on the seller's premises. Packing, marking, and other necessary work can be done while the goods are in bond.

the import of produce. This will vary with each type of produce, and some documents will be peculiar to a particular importing house. What is intended is to give the student a picture of the methods whereby all types of produce and raw material are handled when imported into this country.

¹ The scheme was proposed by Sir Robert Walpole in 1733. It was unpopular at first, but was finally adopted in 1803.

² 1880, 1883.

The Export Trade.—The export of merchandize is still largely in the hands of :—

1. Export merchants who forward manufactured goods to buyers, or branch establishments abroad.
2. Buying houses who indent for numerous articles from manufacturers, and invoice them under their own names.
3. Forwarding agents who pack and forward the goods received from traders in this country.

From the beginning of the nineteenth century up to 1870, England was the workshop of the world. Throughout this period few of our manufactures were challenged by foreign nations. Since that date practically all our manufacturing export industries have felt the quickening effects of foreign competition. In spite of half a century of foreign rivalry this country still retains extensive world markets of high grade cotton and woollen goods, iron and steel goods, ships and machinery. Our large manufacturing export industries have behind them four or five generations of skill in organization which gives them an advantage over the foreign industries which have been modelled on them.

With the exception of coal, the exports from the United Kingdom consist mostly of manufactured goods—finished and partly finished goods. The following table gives the value of the more important exports from the United Kingdom for the years 1924-6 :—

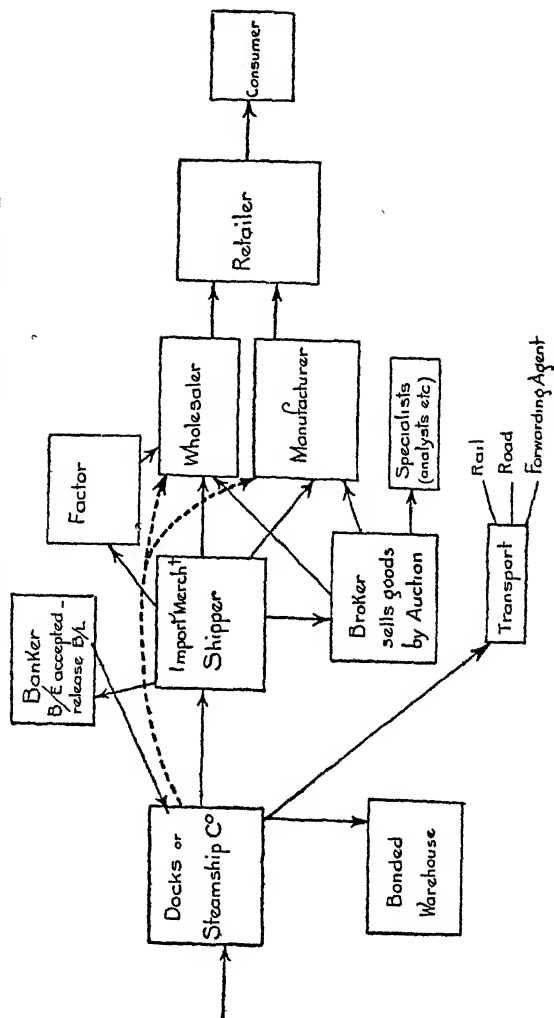
INTERNATIONAL TRADE—*Continued* 179

| <i>Commodity</i> | 1924 (Unit £1,000.) | 1925 (Unit £1,000.) | 1926 (Unit £1,000.) |
|-------------------------------------------------------------|---------------------------|---------------------------|---------------------------|
| Total Exports . . . | 800,966 | 773,380 | 651,892 |
| Cotton yarn and manufactures | 199,297 | 199,305 | 154,343 |
| Iron and steel manufactures | 74,548 | 68,162 | 55,077 |
| Coal | 72,080 | 50,477 | 19,138 |
| Woollen goods | 67,794 | 58,957 | 51,416 |
| Machinery | 46,700 | 49,069 | 45,538 |
| Wearing apparel | 30,040 | 28,903 | 27,320 |
| Textile manufactures other than wool and cotton. | 27,564 | 27,888 | 26,744 |
| Vehicles (ships, etc.) | 26,881 | 32,754 | 30,583 |
| Chemicals | 25,497 | 23,577 | 21,639 |

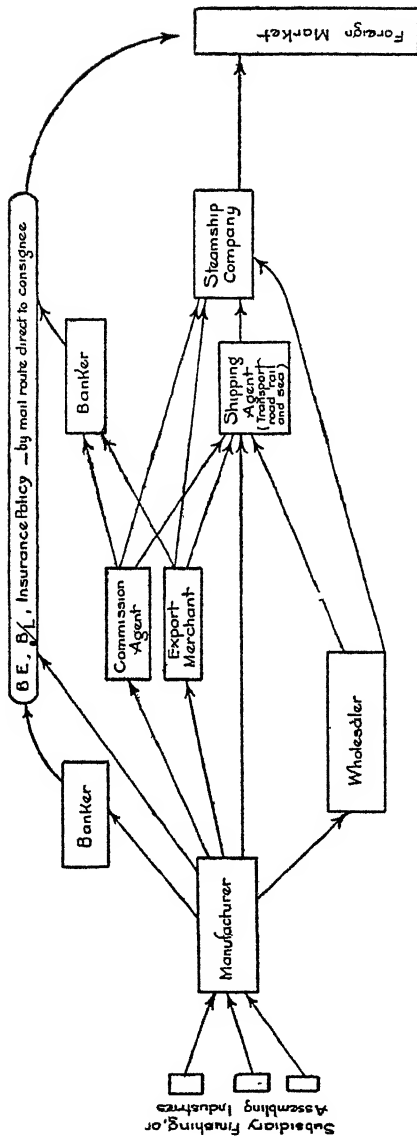
Organization of the Export Trade.—The type of organization existing in any branch of the export trade will vary according to (a) the nature of the product exported, (b) the size of the manufacturing firm, and (c) the country to which the product is exported. The diagram on page 181 indicates the possible channels through which a consignment of goods may pass.

Many of the larger manufacturing firms will probably ship direct to their customers abroad; they may even make their own arrangements with the shipping company and so eliminate all intermediaries between them and the foreign importer. With the growth of international concerns there is an increasing tendency for this practice to operate. Manufacturing firms which have not the same facilities for gaining access to foreign markets, may deal through an export house in England, through a wholesaler, or through a special commission agent resident in this country, and acting on behalf of a foreign buyer.

Organization of Import Trade



Organization of the Export Trade



PROBLEMS AND EXERCISES

1. What attempts were made in Great Britain to organize foreign trade before the nineteenth century (Chapter I).
2. Look up the official figures of Britain's imports and exports in the *Statesman's Year Book* and compare them with the figures given in the text. Try to account for progress that has been made under the various headings.
3. What equipment and knowledge are required of the wholesale importer of merchandize?
4. Give an account of the work of a broker on a wholesale produce market.
5. What advantages (if any) might Great Britain obtain in international trade from the use of a decimal coinage?
6. Why is not a country's foreign trade necessarily a good index of its prosperity? Contrast the significance of the foreign trade of the United States and Great Britain.
7. What are the losses (if any) inflicted on a country's trade by the imposition of a tax on a commodity imported? What would be the probable effect of taking the tax off tea altogether in this country?
8. How would you test the economic progress of a community?
9. What are the four main advantages of foreign trade? Can you mention three probable disadvantages?
10. Why is it true to say that "imports must be paid for by exports"? When is it not true? If gold is exported to settle the balance of indebtedness, is gold not an export?
11. Give six reasons why Great Britain was able to support a great and growing population during the nineteenth century? Can you give any reasons why this state of affairs should not continue?
12. Why was the exporting of merchandize encouraged when men perceived the advantages of international trade? (The Mercantile System.)
13. How do governments assist foreign traders to-day? Contrast the position to-day with that in mediaeval times in Europe.
14. Why were Spain, Portugal, and Holland in the position of commercial leadership before Great Britain? Give the geographical, political, and economic reasons why Great

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Britain has maintained the commercial leadership which she gained between 1650 and 1750?

15. How far is it true to say that "England's foreign trade was built upon a firm foundation of domestic trade and manufacture"?

16. What have been the changes in the character of Britain's export trade since 1800?

17. What is a bonded warehouse? Give the procedure for putting goods into bond and drawing them out.

18. Give as full a description as you can of the business methods of exporting merchandize under the following headings: (a) dealing with orders received, (b) packing and marking, (c) forwarding, (d) insurance, (e) formalities of customs, (f) certificates of origin, (g) consular invoice, (h) invoicing of the goods.

19. How is payment usually made for goods exported? Describe the procedure fully.

20. Give an account of the growth and activities of the Port of London. (This should be preceded by a visit to the Docks.)

21. What are the causes which have contributed to a decline in the foreign trade of Great Britain since the War? What remedies have been suggested to restore our trade?

22. What commodities would still figure in world trade in spite of tariff barriers?

23. Trace the economic effects of a large increase of tariffs on goods imported into Great Britain.

24. From the figures on page 179 relating to the exports from the United Kingdom in the years 1924-6, estimate—

(a) The percentage of the value of each commodity for the three years to the total value of the exports for the year in question.

(b) The percentage of all the items enumerated to the total exports in each year.

25. What general deductions would you draw from the figures given?

26. From the copy of the *Statesman's Year Book* in your public library show by means of percentage calculations any alterations that have taken place in our import and export trade, and account for the variations if possible.

FURTHER READINGS AND REFERENCES

- Withers, Hartley. *Money Changing*, chaps. v and viii.
Harvey. *Import and Export Trade*.
Bowley. *England's Foreign Trade in the Nineteenth Century*.
Official. *Food and Raw Material Requirements of United Kingdom*. Cd. 8123.
Report on Co-operation in the American Export Trade
(Federal Trade Commission, 1916).
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CHAPTER XIV

THE FINANCE OF FOREIGN TRADE

The system of modern banking and credit has developed alongside the vast growth in the exchange of goods and services in this country, and economizes the use of metallic currency. Payments that have to be made to discharge international indebtedness are the subject of a study known as " Foreign Exchange ". The organization of an international credit system, although merely an extension of the home system in that it obviates the use of gold for all transactions, possesses special characteristics. The whole purpose of the organization is to cancel the debts owed by persons in one country (A) to individuals in another country (B) by setting off against them the amounts owing by persons in country (B) to persons in country (A). The risk involved in sending gold bullion is obviated, and time saved, for money need not be sent to settle each individual transaction.

The Nature of International Payments.—The payment of money, or the cancellation of a debt, between two people resident in different countries differs from a payment made in the home trade in the following respects :—

1. *Distances may be greater.*—Generally speaking debtors and creditors in the home trade are within easy

reach of one another. In foreign trade they are often separated by thousands of miles. Time and distance are, however, not such important factors as the crossing of the frontiers of the national banking system. It is easier to settle indebtedness within the national boundary of a vast area like the United States of America than between traders in England and France, because of difference of currency.

- 2 *Foreign Currencies*.—In the absence of an international currency the system in one country has to be interpreted in terms of the currency of another. Even the standard gold coins of different countries differ in content and therefore in intrinsic value, and calculations have to be made to show the relationship of currencies.
3. *Differences in legal and banking systems*.—Manners, habits, banking and legal systems, and the level of business morality vary in different countries.

All these hindrances are unknown in making payments within the national boundary. There is no international clearing house for the settlement of the balance of debts, and gold often moves from one country to another. Formerly, as has been pointed out, the bill of exchange was the main instrument by which foreign exchange was conducted, but international banking tends to render the bill of exchange unnecessary. When banks in Paris keep current accounts with those in London, and the business man applies to his banker in Paris to settle his account in London, a telephone message, cable, or letter is all that need be sent to the agent in London. Thus debts are settled in much the same way as with the cheque system. Of course, the banker must not charge his

customer too much for the service he renders, or our Paris business man would send a bill of exchange he had bought; or if this method were also very dear, he would actually send gold, paying the charges for insurance and carriage by land and sea. Obviously the debtor is anxious to discharge his indebtedness in the cheapest way.

The Measurement of International Indebtedness.—Within the national boundary value is expressed in terms of a standard coin. The relationship between the standard coin of one country and that of another at any particular time is called a *rate of exchange*. The rate of exchange thus depends on the comparative gold values of the respective units in the two countries, for gold is a world product of universal value. If two countries have a gold coinage, the standard coins (on which all the others are based) of the countries can be equated by finding the amount of gold in each coin. Thus the gold napoleon of France and the sovereign of England can be compared :—

| | |
|--------------------------|-----------------------------------------------------------|
| One English sovereign | |
| made of gold 11/12ths | |
| fine | contains 7.32238 grammes of pure gold. |
| One napoleon (20 francs) | |
| made of gold 9/10ths | |
| fine | 5.80645 " " |
| One English sovereign = | $\frac{7.32238 \times 20}{5.80645}$ francs = 25 2215 frs. |

This is known as the *Mint Par of Exchange* between London and Paris; one English sovereign is equivalent to 25.2215 francs. This does not fluctuate, for the weights of gold in the coins are fixed by law in each

country. The Mint Par of Exchange of the chief gold-using countries of the world is as follows :—

| | | |
|---------------------|---|----------------------|
| France ¹ | . | £1 = 25·2215 francs. |
| Germany | . | £1 = 20·429 marks. |
| U.S.A. | . | £1 = 4·8865 dollars. |
| Holland | . | £1 = 12·071 florins. |
| Norway | . | £1 = 18·159 kroner. |

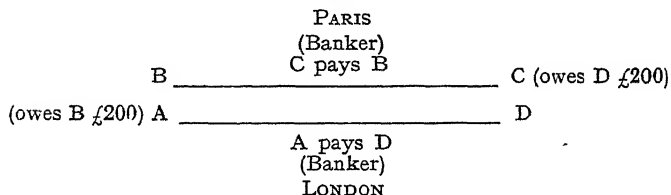
The currency of a country, as the student knows, may, in fact, consist of paper money that is not convertible into gold by a central bank on demand.

The fluctuations of the exchanges are shown each day in the newspapers, and are usually expressed as the number of dollars, francs, marks, etc., that would be received in exchange for £1 sterling. High rates, when the exchange is expressed in this way, are favourable to this country, and low rates unfavourable. When the London-Berlin rate is 20·48 (par of exchange = 20·43) the £1 sterling will buy more German currency, and the rate is said to be rising. Confusion sometimes arises because the rate is expressed in the home instead of the foreign currency. A rising rate of exchange thus means that importers of goods from Germany pay a little less for their goods than they anticipated, and exporters to Germany get a little less. When the rate is against us it tends to discourage the importation of goods from a foreign country and encourage exports to that country, and thus restore the balance of trade.

The Importance of the Bill of Exchange.—The supply of foreign money consists of bills of exchange, bankers'

¹ A new Monetary Law, introduced on 24th June, 1928, stabilized the franc on a gold basis. The franc, according to this law, consists of 65½ milligrammes of gold, $\frac{1}{10}$ fine.

drafts of all kinds, banknotes, cheques, and coins. The Bill of Exchange has been the chief instrument for the settlement of international debts since the Middle Ages, and it is desirable that the student should understand clearly its utility.



Let it be assumed that *C* in Paris owes *D* in London the equivalent of £200; and that *A* in London owes *B* in Paris the same amount. Without the use of a bill of exchange, gold or notes would be transported both ways to settle the debts. By means of a bill *B* in Paris draws on *A* in London for £200, i.e. gets *A* to promise to pay the £200 say three months after the date of the receipt of the bill. (*A* accepts this bill by signing his name across the face of it.) Now let us assume that *B* in Paris discounts (sells) this bill with his Paris banker. *C* in Paris, who owes £200 to *D* in London, buys this bill from the Paris banker, and sends it to his creditor in London. When the bill falls due at the end of the three months, *D* can present it to *A* in London, who will then pay it. If *D* had needed his money before the bill was due, he could have sold it to his banker in London, who would duly collect the amount.

By means of this bill of exchange, the debts were settled without having recourse to the export of coins,

or notes. The bill might have changed hands many times in the settlement of debts, just in the same way as a banknote does; therefore, the same bill can settle many debts.

In order to see how the supply of bills of exchange affects the rate of exchange, the following diagrams should be studied. It is assumed that the transactions take place between merchants resident in the United States of America and merchants resident in England.

Case I.

| | | | |
|----------------------------|---------------------------|------------------------|---------------------------|
| <i>A</i> in New YORK | <i>B</i> in BOSTON | <i>C</i> in CHICAGO | <i>D</i> in PITTSBURG |
| exports goods | imports goods | exports goods | imports goods |
| valued at | valued at | valued at | valued at |
| £6,000 | £2,000 | £3,000 | £7,000 |
| to | to | to | to |
| <i>M</i> in MANCHESTER. | <i>N</i> in NEWCASTLE. | <i>O</i> in OLDHAM. | <i>P</i> in PETERBORO. |

As a result of these transactions—

The total exports to England are £9,000.

The total imports from England are £9,000.

The exchange will be at par, for the supply of and the demand for bills of exchange will be equal in both countries. Therefore the rate of exchange will equal Mint par of exchange, i.e. £1 will buy 4·8865 dollars.

Case II.

Let us assume a similar series of transactions, but substitute the following figures for those in the previous example.

| | | | |
|--------------------------------------------------------------------------------------|------------------|------------------|------------------|
| <i>A</i> exports | <i>B</i> imports | <i>C</i> exports | <i>D</i> imports |
| £6,000. | £1,500. | £2,000. | £10,000. |
| The total exports of the U.S.A. are now £8,000; and | | | |
| The total imports " " £11,500. | | | |

America owes England £3,500 on balance; there is a balance of indebtedness in favour of England. Now debtors in the United States who want to settle their debts with England will buy bills due and payable in England. On the assumption we have made, there are acceptances available to the amount

of £8,000 only, while there are debtors wanting to pay £11,500. American merchants will, therefore, compete with one another in buying the bills available with the result that the price of bills on English business men will rise in America. Each American debtor will have to pay a little more than he expected. Bankers who are alive to the possibility of making money will create bank bills to meet the demand, but the value of the dollar in terms of sterling will decline. Bills on America in this country will be at a discount.

From what has been said the following facts should now be clear :—

1. As long as there is no international currency, and nations use different coinage systems, there will exist a Mint par of exchange which measures the system of one country using gold in terms of the other. If a country uses silver only as a standard, the rate of exchange will fluctuate with the value of silver and gold in the markets of the world, and there will, therefore, be no Mint par of exchange between gold and silver using countries.
2. If a person wants to discharge a foreign debt, it does not follow that he can always settle the debt at the Mint rate. The price he will pay for a foreign bill or for foreign money will depend on the supply of bills, etc., that are available for him to buy and the number of persons in his own country who are also wanting to settle similar debts in the foreign country. The actual rate of exchange will therefore rise or fall above or below the Mint par of exchange as the influence of supply and demand is felt.

Specie, or Gold Points.—Specie, or gold points are the limits beyond which it will be cheaper for merchants to settle their debts by sending gold out of the country, or bringing it in, rather than by buying bills of exchange. The *gold export point* from this country is reached when the rate of exchange is lower than the Mint

par of exchange *plus* the cost of transporting and insuring gold to the foreign country. As foreign countries, except the United States, nearly all place restrictions on the export of gold bullion, a *gold import point* may exist in name only.

PROBLEMS AND EXERCISES

1. "In the case of the few silver-using countries the rate of exchange will, of course, be influenced by fluctuations in the relative value of silver and gold" (Hartley Withers). Give an example to show that a rise in the price of silver will affect the price of silver coins in silver-using countries. What effect does this fact have on the exporter of British cotton goods to China? How is the risk overcome?
2. What is a holder in due course of a bill of exchange? What is meant by a holder for value?
3. What are the classes of endorsement on a bill of exchange?
4. "The Chinese merchant who sells his tea in Russia, or Germany, his silk to the United States, is reimbursed through the London market" (Guyot). What machinery brings this about and how?
5. From the prices of wheat, barley, oats, beef, mutton, tea, coffee, butter, timber, and textiles, published in *The Times*, construct an index-number to show the value of money at two different periods of time.
6. "The world's interchanges of goods, services, and securities are financed by the marvellous bits of paper that pass current because somebody's name is written across them" (Withers). To what bits of paper is Mr. Withers referring? Explain how the interchanges are financed.
7. How does the settlement of debts between traders in different countries differ from the settlement of debts between traders in the same country?

8. How is international indebtedness measured ?
9. How do you account for fluctuations in rates of exchange ?
10. Show how a single bill of exchange can settle many international transactions.
11. What reasons can you give for the supremacy of British banking ? What advantage to our banking system is our large foreign trade ? What might be the effect of our having a purely paper currency ?
12. Why is the Bank of England constantly watching the rate of exchange between this country and the United States ? Why does it control the money market to regulate this exchange at times ?
13. What is a documentary bill of exchange ?
14. The Balfour Committee on Industry and Trade (Cmd. 3282) consider that "in principle the resumption of the gold standard was unquestionably necessary and ultimately beneficial". Discuss this question in the light of the supremacy of British banking.

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CHAPTER XV

STATISTICAL MEASUREMENTS IN COMMERCE

In the days of the old craftsman, who fashioned an article himself from beginning to end, it was fairly easy to calculate the cost of production of articles of commerce, and also the "just price" at which they should be sold to give a satisfactory profit to the maker of them. If the master-craftsman employed apprentices and taught them their business, the costs of labour, primitive tools, supervision, and the upkeep of the establishment, were readily arrived at.

Modern business involves the keeping of much more detailed records than were kept in the past, and requires their prompt and careful co-ordination for the following reasons :—

1. The extraordinary development of the process of division of labour. Specialisation takes place at each stage in the process of manufacture and distribution.
2. Expensive factories and machines are used. These sometimes remain idle for periods, and tend rapidly to deteriorate and become obsolete as new inventions or discoveries are made. The efficiency of plant and machinery must be known.
3. Businesses have to maintain selling organizations of experts in touch with markets.
4. Much of the work of distribution must be done by the manufacturers themselves. This involves the

- upkeep of transport fleets ; motor lorries, barges, and steamers.
5. The work of buying raw materials necessitates a close study of economic conditions and trends of market prices. Stocktaking must take place at frequent intervals, or perpetual inventories be made.
 6. The work of management and organization becomes more expensive.
 7. Competition forces prices to the lowest levels, and records must test the efficiency of the processes of manufacture with machines.
 8. Waste must be prevented.
 9. A comparison of costs in one period and another must be possible.
 10. Selling prices can only be determined if the exact cost of the various items is known within recognized limits.

A system of obtaining more accurate costs was introduced by Sir John Mann in 1891. Before the use of cost accounting systems the indirect costs of production (oncosts: indirect material, indirect labour of supervision, rent, rates, taxes, insurance, interest charges, repairs, light, heat, etc.), were reckoned by rule of thumb methods, and the adding of a percentage to the prime costs to cover all the items enumerated. The costs of selling and of general administration were also matters of guesswork. When business was slack, and the turnover was reduced, the percentage added was often found to have been too low when the final accounts were made up at the end of the year ; in times of good trade it was often too high.

Companies now make every effort to discover the true costs of production by classifying their actual

sub-divisions will often be necessary, and even a different scheme of classification. But no matter how simple or complicated the analysis, true production cost and commercial oncosts can only be obtained if unbiased records are kept. A moment's reflection will also disclose the fact that many of the costs mentioned do not vary with the output of the factory. The owners will pay the same rent for the buildings whether the works are uniformly busy or not ; some of the plant and machinery will depreciate more if it is not used ; the costs of insurance, lighting, and heating the buildings may be just as much if the works are comparatively idle. Other costs will vary directly with the volume of business done.

Oncosts vary little with changes in the amount of Production.—In modern business, where machines are used, oncosts form a large element of the total cost, and they have to be apportioned so carefully that the total cost of every part of every article produced is known. This is the great problem of cost finding. Arithmetical accuracy can only be secured with such items as direct materials, direct wages, and works disbursements. With all the disbursements, services, etc., that have to be spread over the whole of the products of a works, an approximate apportionment only is possible. The approximations must be sufficiently accurate, however, to represent a true state of affairs.

Administrative Records.—In order to arrive at the true cost of production of each article made, and to compare the cost of different methods of manufacture

and discover leakages and losses, records must be collected under each of the headings we have suggested. The *Works Wages* department will need information concerning :—

- (a) Employment records.
- (b) Timekeeping. Time and card recorders help with this.
- (c) Wages paid for a particular operation, or job.
- (d) Wages statistics.

For the *Materials* used in the works special records will be required under the following sub-headings :—

- (a) Orders.
- (b) The receipt of stores.
- (c) Stores rejected.
- (d) Stores issued.
- (e) Reconciliation statement with Stores Account in the financial books, to show losses.
- (f) Stocktaking records which show balances in hand.

The costs under the other headings given in the diagram will also be collected, prime costs being allocated directly to the product manufactured, and oncosts apportioned to the whole output by one or other of the following methods :—

- (a) The total oncost may be divided by the number of units of product: tons of pig iron, quarters of flour, etc. This method is accurate enough if the output is fairly constant, but not if the output fluctuates. If the number of units produced varies very much, a monthly proportion may give closer results.
- (b) Oncosts can be apportioned to each department.
- (c) Oncosts can be calculated as a ratio of direct wages,

if the amount of machinery and its value are about the same in each department ; or as a ratio of wages and the material used.

- (d) The total oncosts can be divided by the total number of hours the machines are running, machines of one type being grouped together.

A costing system must not be relatively expensive to inaugurate, and it must give the results with rapidity. The board of directors of a large business need to be constantly informed of the results of productive operations, in order to be in a position to decide questions of sales and financial policy. Within a few days of the end of a month's manufacturing the board needs to have its completed records of costs.

Relation between Oncosts and the growth in size of a Business.—The fact that these indirect costs of production do not vary much whether the turnover grows or diminishes causes business managers to strive all the time to increase the volume of their business, or the output of their factories. The greater the number of units of a product manufactured, the lower is the expense per unit in most manufacturing businesses. The constant aim of the business manager, therefore, is to keep his machines and plant operating to their full capacity.

Suppose, for example, a ready-made clothing manufacturer finds that his oncosts amount to £1,500. His prime costs of manufacture per garment are £1. If he can manufacture and sell 1,000 garments a year, he will expend £1,000 in direct costs. His total expenditure will thus be : £2,500.

| | |
|---------------------------------|----------|
| Prime Costs | = £1,000 |
| Production & Commercial Oncosts | = £1,500 |
| | <hr/> |
| | £2,500 |
| | <hr/> |

If his selling price per garment were £2·5, he would receive back just enough money to cover his total cost. If he were able to double his output in the same factory with the same machines and plant, he would now turn out 2,000 garments and his costs would be as follows :—

| | |
|---------------------------------|----------|
| Prime Costs | = £2,000 |
| Production & Commercial Oncosts | = £1,500 |
| | <hr/> |
| | £3,500 |
| | <hr/> |

He could now afford to sell his 2,000 garments at £2 each and reap a greater financial reward than before. Considerations of this kind enter largely into modern business enterprise. Obviously there is a wider market, too, for garments at £2 each, than for similar garments at £3 or £4 each. If this man's output were very large, although the prime costs per garment might remain at £1, the oncosts per garment would probably not increase in the same proportion.

When, as has been shown, the indirect costs of production loom very large, where expensive factories and plant are necessary to production, the need to increase the turnover becomes imperative. In order to bring down his costs per unit, the business man may be willing to sell some of his articles at a price which just covers the costs of production. How is it possible for an electricity undertaking to make two different charges to users of its current: one charge for lighting

and a much lower charge for power? The lower price may be scarcely above the prime costs of producing the power. The low price encourages manufacturers to use electric machines instead of gas engines, or steam. Householders are encouraged to use electric fires and machines. The increased number of units of electricity thus used by consumers enables the electricity company to spread its indirect costs over the greater total of units of electric power produced, and thus make higher profits on the whole.

Large Scale Production.—Large-scale production thus becomes an increasing tendency in modern times under conditions of increasing returns. The more articles that can be produced by a factory, the more units of electricity by one plant, the greater the proportionate return to the capital employed. Indirect costs are a heavy burden to the small-scale producer. The larger business can often set up new departments to make use of the by-products and scrap material without proportionately increasing production and commercial oncosts. A further increase of sales with main products and by-products again reduces costs per unit.

But with the ever-increasing size of the business unit comes an increasing danger. In a large business a slight reduction in the turnover, or a lowering of price, may make a vast difference in the final results of trading. A simple arithmetical example may be taken to illustrate this. Suppose a company, whose total income is represented by 100, and whose prime costs of production, and oncosts, can be represented

by 30 and 60 respectively, increases the volume of its business by 10 per cent., and the oncosts remain constant. The table below gives the position of the company before and after the increase in trade.

| | | | |
|--------------|---|-----|-----|
| TOTAL INCOME | . | 100 | 110 |
| Prime Costs | . | 30 | 33 |
| Oncosts | . | 60 | 60 |
| PROFIT | . | 10 | 17 |

Profits have been increased from 10 to 17. The result of a reduction of the total income by 10 per cent., is shown in the following table :—

| | | |
|--------------|---|----|
| TOTAL INCOME | . | 90 |
| Prime Costs | . | 27 |
| Oncosts | . | 60 |
| PROFIT | . | 3 |

It would be wrong to deduce from the above examples that the results would necessarily be as predicted. We cannot be sure that a reduction of the selling price of an article will be followed by increased sales. But the making of better records becomes more and more necessary. From the study of unbiased records of the kind we have discussed, a man can discover how his business can be conducted more economically. Even direct costs of production can be reduced by improved organization based on the collection of statistics. In a small factory that we know—a model of its kind, well-planned and well-organized—a new works manager (a Scotsman) reduced the direct labour costs per ton of output by one-half in twelve months; and this without reducing the wages of the individual worker. His plan was to calculate from his statistics the maximum output of the factory with the plant

and the machinery working to their full capacity, and then reorganize the succession of processes to save time at every operation. Lest it should be thought that such an apparent "speeding up" would cause discontent among the workers, it may be added that this company has had no labour troubles since the war and has paid good dividends in spite of the keen competition of large-scale manufacturers.

The Curtailing of Competition.—In the desire to extend their sales and keep their works going at full pressure, business men reduce prices lower and lower—sometimes in order to force less well-equipped competitors out of business altogether, and have the whole field to themselves. But we have seen that the growth in the size of the business unit is general, because in each business there is a point where "maximum efficiency" is reached. This point can only be determined by the study of all the factors we have indicated :—

- (a) The relation between the size of the business and direct and indirect costs.
- (b) The marketing problems of the bigger unit :
 - (i) In buying raw materials.
 - (ii) In selling finished goods.
 - (iii) In transporting raw materials and finished goods.
- (c) The financing risks of the bigger unit.
- (d) The relative cost of administration of the small and large unit.
- (e) The use of by-products.
- (f) The application of scientific methods to production and distribution.

PROBLEMS AND EXERCISES

1. What are the four main sources of general business statistics ?

2. Give reasons why statistics are often inaccurate. What business statistics would you expect to be only approximately correct ? What do you understand by an average figure ?

3. How are statistics collected in business ?

4. What is the main object of cost accounting ? For what purposes will the figures collected be used ?

5. What type of costing would be needed for the following businesses : (a) a colliery, (b) tramways, (c) building a house, (d) the making of cotton goods, (e) mass production of motor-cars ? What would be the basis and the unit in each case ?

6. How do you think the following items in the cost accounts of a manufacturing business would be arrived at : (a) the material used, (b) the wages of the workers, (c) the disbursements in the works, (d) the factory on-costs for rent, power, lighting, interest, depreciation, insurance, etc ?

7. What are seven of the items that would be included under the heading of office expenses ?

8. Give a formula which would assist you in fixing a works rate per cent. for the total factory on-costs, if productive wages were the basis.

9. It is desired to obtain a machine rate for a particular machine which cost us £1,000 and will probably last us nine years. Reckon interest at 5 per cent. per annum, depreciation each year at 10 per cent. of the cost ; rental cost of space occupied by the machine, 300 sq. ft. at 2s. per sq. ft. per annum. Suppose the machine were normally used 48 hours weekly for 50 weeks per year, what would be the cost per hour of the machine apart from the running expenses ?

10. The expenses of using a machine were as follows :—

| | Per Hour | |
|-------------------------------------|----------|----|
| | s. | d. |
| Cost per hour of machine . . . | 1 | 8 |
| Cost of power to run machine . . . | 1 | 0 |
| Cost of repairs to machine . . . | | 4 |
| Wages cost of running machine . . . | 2 | 3 |
| General works rate . . . | 4 | 9 |

What would be the cost per unit if 40 units of product were turned out in one hour on the average?

11. Find out what statistical books the secretary of a public limited company needs to keep.

12. What is the object of "index numbers"? What are the data for obtaining index numbers? What commodities must be shown to obtain reliable index numbers?

13. Should wages fall with the cost of living? How is the "cost of living" arrived at? Give examples of wages and salaries in the United Kingdom based on cost of living rates.

14. What three things does the cost of manufacturing depend on in any country? Estimate the relative importance of (a) natural resources, (b) industrial factors, (c) efficiency of labour. To what do you attribute the economic progress of the United States in the last 50 years?

15. What relation exists between the cycle of production of crops and commercial cycles? How does the spread of information tend to obviate the worst effects of such cycles?

16. If 50 lb. of tea at 2s per lb. are mixed with 100 lb. of tea at 1s. 6d. per lb., what would be the cost of the mixture per lb.? 200 unskilled workmen are employed at 55s. a week and 50 skilled workers at 84s. a week, what is the average weekly wage per workman?

17. The above are called "weighted averages". How would you define a weighted average?

18. What are the chief sources of foreign trade statistics? Why are definitions important in the statistics of foreign trade? What is a ton (a) in France, (b) in the United States, (c) in the United Kingdom?

19. What is meant by "commodities" in foreign trade statistics? Are bullion, new and old ships, paper money, ships' stores, the goods of passengers, travellers' samples, "commodities"?

20. If you compared the figures of exports from the United Kingdom to the United States and the United States figures of imports from the United Kingdom into the United States, would the figures agree? What value would be included in goods landed in Liverpool from the United States that might not be included in the goods leaving Liverpool for the United States?

21. If you had charge of the keeping of records in a manufacturing business, what would you tell the management your aim was ?

22. If you were appointed the general manager of a large manufacturing business, what reports would you expect to get from the productive, purchasing, personnel, sales, and accounts' departments ?

23. What statistics might be useful in checking waste in a motor transport delivery department of a company ?

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CHAPTER XVI

BUYING

From our study of marketing and the growth of markets, we have seen how the products of the whole world have been made available to the buyer. With the growth of specialization in buying, much wider knowledge of business as a whole is demanded of the buyer. If he fails to concern himself with events outside his immediate spheres of interest, he may not observe disturbing factors which react on his own markets. One of the striking developments of recent years is the enormous output of information regarding merchandize of all kinds: world crops and supplies; technical information concerning methods of manufacture, and methods of marketing.

The buyer must follow the trends of prices closely, be able to interpret statistics of production, and judge the market influences which affect prices. But he must not be guided by price alone; he must relate prices to quality. It is the purchase of the right quality of merchandize at the lowest possible price that must be his guiding principle. The quality of all the goods he buys must be tested independently on delivery, and accurate records kept of quantities. Where large quantities of one particular kind of goods are bought, an expert can usually be employed to carry out these tests. The buyer will not as a rule rely on one source

of supply of the commodities he needs, but will keep records of all possible sources, and spread his orders in order to prevent failure of supply from any one source. If he is buying a staple commodity, he knows that crops may fail in one part of the world owing to lack of rainfall, or strikes, and that supplies may not reach him through temporary breakdowns of the transport service.

Buying bears a fundamental relation to production on the one hand and to consumption on the other. A steady flow of the right kind of supplies is desirable at the time they are required. The manufacturing company, the wholesaler, or retailer, is anxious not to hold larger supplies of commodities than are really necessary to meet immediate demands or emergencies. Goods of all kinds tend to deteriorate if kept too long; money is locked up by holding raw materials or manufactured goods that cannot be disposed of rapidly, money that might be used to better advantage; space is taken up in warehousing surplus goods; insurance costs absorb profits; and prices of the merchandize held may move downwards. From his experience and judgment, based on the keeping of careful records, the buyer, whether he be a manufacturer or middleman, will be able to make the right decision as to when and how much to buy. It is generally recognized that the success of a commercial or manufacturing undertaking is in a large measure due to the skill which is exercised in buying. Much discussion has centred round the relative importance of buying and selling. Good selling will never make amends for bad buying.

Sometimes, indeed, it is impossible to sell goods that have been badly bought ; goods which do not satisfy the local demands by reason of unsuitability of design, quality, or price. Thus the salesman is dependent on the buyer for his living. The greater the skill of the buyer the greater will be the advantages that attach to the merchandize and the quicker the rate of the turnover. The buyer is therefore the economic pivot round which the proper functioning of the business revolves. This is the reason why managing directors often buy their own raw materials, or else delegate the task to an expert who is given the widest possible discretionary power.

Functions of the Buyer.—The first and most important function of the buyer is to correlate demand and supply. On the one hand he must study the demand of the consumer, and on the other hand he must have a thorough knowledge of processes of production and the possibilities of increases or decreases of supply. There are few men who are more directly affected by the operation of the law of supply and demand than a buyer in any large house of business. He must quickly sense any cause which influences either of these forces. If he is buying to retail again direct to the public, he must be alive to every possible change of fashion or demand, and must always bear in mind that new processes may render present demand for an article ineffective. It would be fatal for a buyer to purchase large quantities of any raw material which is likely to be superseded by a supply of a cheaper synthetic product.

A knowledge of markets—and in most cases of world markets—will make a demand on the buyer to develop a wide vision of areas of production and consumption. His breadth of vision must be far wider than that of the salesman. It is possible that these qualifications can be obtained by intensive study and training. Indeed, without study and training he cannot hope to acquire a knowledge of the law of contract and agency, which is essential to his function. But there are other qualities of mind needed in buying which are probably dependent to a large extent on the inherent gifts of the buyer :—

- (a) Business sagacity—not usually possessed by the dreamer, philosopher, or idealist.
- (b) A strong buying sense. A sense of values.
- (c) The ability to think and act quickly, and the courage to back his own judgment.
- (d) Imagination and vision to foresee possible demands.
- (e) The ability to forecast possible trends of market prices.

These are only a few of the qualities which good buying demands ; most of them can be acquired by experience, but some are due to special aptitudes, inherent qualities of mind and temperament. The successful buyer fully appreciates the educative value of mistakes. The records which the buyer keeps will prevent him from making the same mistake twice.

Active and Passive Buying.—Buying must be differentiated from the process of “ order-giving ”. In many small businesses the buyer is restricted in placing orders ; the one-man retailer is often forced

to buy in one market. The modern tendency to increase the supply of branded goods in every sphere of production, the use of advertisement in training members of the public to demand standard products, the power of the large combines to refuse supplies unless goods are retailed at a certain fixed price—all of these tend to give the wholesaler and retailer less choice in buying. In many trades, e.g. the textile trade, where standardization of raw materials and finished products is not so easily achieved, the buyer must exercise a wide power of choice in the quality and quantity of his purchase. In any case the buyer should always be willing to see salesmen with new goods to offer. He must eliminate prejudice. In a society where nothing is static, the buyer must possess elasticity of mind: he should maintain touch with every phase of human activity which bears directly on the merchandize he handles, and create new uses for his merchandize, for he can sometimes exercise a powerful influence on the demands of the public.

The Organization of Buying.—We have already touched on the legal and financial aspects of buying. In an elementary work of this kind, which is concerned with the explanation of the principles of business economics and not with the detailed methods of business organization, we can only point out the way to lines of study and express the hope that the young student of business science will keep a loose-leaf notebook handy in which he will enter examples of the different types of organization he meets with in his practical experience, and copies of documents and

their uses. The organization of a buying department in a manufacturing business and in a large store will have much in common.

- (i) There must be a decision on the exact nature of the goods required, and the exact quantity, and the dates of delivery.
- (ii) The orders for the goods—written on special forms—must be placed.
- (iii) Arrangements must be made to obtain the prompt delivery of supplies, and for their careful inspection on delivery.
- (iv) The custody of the merchandize, and its issue from stock must be supervised. (In the case of raw materials the cost must be allocated to the particular job.)
- (v) A method must be devised in a manufacturing concern for the recovery of waste material.
- (vi) Methods for the elimination of waste and the use of by-products must be studied.

In all large retail stores there are buyers who specialize in one or two commodities. Each buyer is responsible for his own department, is given a certain amount of credit by the directors, and is expected to show a return of profit on this credit. His remuneration will usually consist of a percentage of the profits made by his department. He is thus almost in the position of a sole trader in that he has entire control of his department, his stock, and the staff; but his capital is, of course, borrowed from the company he is working for. He can buy as a rule from any source he wishes—the test of his success being his ability to turn over his stock rapidly. In some manufacturing businesses, too, there is one buyer—or a small committee of

buyers—responsible for all the buying. Few men can be expected to buy well over a wide range of goods.

In many of the smaller, old-established firms, buying operations are conducted by traditional methods or by custom. The conditions may appear to be static, as the firm's customers are of long standing. It is true to say, however, that buying methods which are not sensitive to changes of demand, that always make use of certain traditional channels, will eventually give way before the attack of more modern scientific methods.

In the larger companies—trusts and cartels—and in the larger chain-store companies, the buying is centralized. It is conducted from a central office. Uniform methods of buying material are established, for uniform supplies generally enable the buying house to obtain better prices from the manufacturers. The only objection to the system is that the initiative of the departmental managers is reduced, and the progress of the department retarded. Individual responsibility generally results in greater effort.

In conclusion we would add that the study of commercial law is fundamental for all buyers and sellers. Every purchase and sale that is properly conducted results in a contract being made at law, and it becomes necessary to know the exact responsibility of buyer and seller in regard to such matters as delivery, incorrect quantities, inferior quality, terms of payment, etc. The Sale of Goods Act, 1893, should be studied in the books on commercial law mentioned below. All of these books can be obtained from a public library.

PROBLEMS AND EXERCISES

1. "When prices are likely to rise, people rush to borrow money and buy goods, and thus help prices to rise; business is inflated, it is managed recklessly and wastefully; those working on borrowed capital pay back less real value than they borrowed and enrich themselves at the expense of the community" (Marshall). Discuss this statement fully, and show what is likely to happen if there is a fall in prices.
2. Explain how a rise of 100 per cent. in the price of agricultural products—which enriched farmers and land-owners—would be likely to affect artisans normally spending say, three-fifths of their wages on staple food products.
3. Name as many methods of making purchases as you can. What is an "option"? What is a "future"?
4. When does the buyer "accept" in the performance of a contract? In the case of rejection, must the buyer return goods to the seller?
5. How is a contract made in the ordinary way of commerce to-day? Give a list of contracts that must be made "under seal" before they are valid in British law.
6. What is meant by "consideration" in law?
7. What simple contracts must be in writing?
8. In what ways may "a breach of contract" arise? Are "damages" the only remedy for breach of contract? What is the main rule governing the measure of damages?
9. What is a "statute-barred" debt?
10. Why should we in buying keep our eyes open for "substitutes" for the things we are buying at present?
11. Why do not retail traders have to distinguish between buying and selling? Criticize the dictum "goods well bought are already half sold". Distinguish between buying articles and selling them in the same form as that in which they were bought and the buying of raw materials for manufacture.
12. Why is the process of buying different in a manufacturing business from what it is in a modern retail store?
13. How can maxima and minima stocks be fixed in a manufacturing business? In making a requisition for supplies what three things do we want to know? What is the advantage of having a list of supplying houses authorized by the managing director?

14. How would you ensure that you were obtaining the precise goods ordered? In the consideration of sources of supply of necessary raw materials, what are important factors?

15. Discuss fully the following factors in buying raw materials: (a) distant or near sources of supply, (b) costs of transport, (c) currency difficulties, (d) the question of interest due to the time that elapses between goods being bought and sold.

16. Draw up the details of a plan to check the receipt of goods bought by a company.

17. What plans have been made recently by business men for the standardization of business documents, such as invoices, etc.?

18. How would you organize the stores department of a large factory? How would you deal with receipts, issues, store-keeping, checking stocks, keeping continuous stock records?

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CHAPTER XVII

SALESMANSHIP AT HOME AND ABROAD

Recent discussion has shown that marketing and salesmanship are often thought to be synonymous. Marketing, we have seen, is the method of distributing commodities. It is concerned with problems of handling, transporting, and storing goods; it studies the channels through which merchandize passes on its journey to the consumer. Salesmanship is a function of marketing; it is brought into play at every point in the marketing scale where change of ownership (a sale) takes place; importer to wholesaler—wholesaler to manufacturer—wholesaler to retailer—retailer to consumer.

The extraordinary industrial development of the United States, Germany, Japan, and other countries since 1870 had, even before the war, brought home to business men the need of improving their methods of selling goods at home and abroad. Since the war the demand for new markets has increased, and more and more attention is being paid to salesmanship as a means of bringing about a more scientific distribution of goods. This probably is the reason why better methods of marketing are linked up with improvements in the technique of selling. In business economics we have

to consider the subject from the point of view of the consequence of salesmanship to the community. Some of the more practical aspects of education for salesmanship have been made the subject of inquiry and study by a Government Committee recently.

A sale of goods takes place to satisfy the wants of a buyer, who, if he is not the ultimate consumer, nevertheless has the consumer in mind. It has already been pointed out that the production of wealth takes place in response to a series of articulated or anticipated wants. A want is a desire to possess something; a demand is a want together with the ability to buy, i.e. purchasing power. Wants only become effective in economics when they are translated into demands. Wants are almost insatiable; demands are limited by the spending power of a person or community.

An increase in the variety and complexity of wants is a pre-requisite to an advanced civilization like that with which we are familiar. One of the chief differences between the primitive savage and the member of a civilized community is that the savage has relatively few wants. To increase the wants of human beings is to civilize them. It is often erroneously imagined that to induce people to limit their wants is to remedy many social evils. If this were true, we should try to educate people to desire just the bare necessities of life, and a minimum of food, clothing, and shelter. The result of such a retrogression would be disastrous economically if not morally. Economic progress, the raising of the standard of living, is due to men and women using their energies to satisfy desires for better food, better

houses, better hygienic conditions, better means of transport, better ways of living.

Salesmanship attempts to render the wants of people more effective in the form of demand, and, by suggestion or advertisement, create further wants in the mind of the customer. But since the complete satisfaction of the customer is the only test of good selling, the true function of salesmanship lies in assisting the buyer to make a right choice of goods to satisfy his need. But, as we have said, wants are elastic; and within the limits laid down in the following discussion, the aims of salesmanship are perfectly sound. The greater the demand for goods the more easily can mass production be adopted, and the cheaper will be the commodity to the consumer. The higher standard of living of the worker to-day is to a large extent the result of mass demands for such things as furniture, clothing, motor-cars, wireless instruments, gramophones, etc. A motor-car for £100 was unheard of in 1912. Mass demand for cars has enabled thousands to be produced at a price so low that even people of moderate means can purchase one. Salesmanship in this sense goes hand in hand with economic progress: it interests people in new goods, new varieties of products, new inventions, and is constantly finding new markets as prices are reduced, or as new demands are created.

But there are limitations to the utility of salesmanship. We must remember that salesmanship can be viewed from (a) the point of view of the producer, or seller, and (b) from that of the community generally. The two points of view are not necessarily coincident.

A trader, or a vast combine, wants to sell goods and to make the maximum net profit by so doing. It may be immaterial to either whether the sale is desirable or useful, or in the ultimate interest of the consumer. A manufacturer or his salesman may know that people as a whole will strain to respond to suggestion where the commodity offered appeals to elemental instincts such as laziness, sex, the acquisitive instinct, love of luxury, display, etc. The skill of the salesman will depend on his ability to exploit these wants and to turn them into demands. Modern methods of selling and advertising often divert demands from more beneficial objects by concentrating the attention of people on others that are less desirable from the point of view of the community as a whole. Unfortunately, much of modern retail salesmanship is of this nature. It makes an appeal to primitive wants, and tends to render those wants articulate, when the consumer is not in a position to demand them. We see this in practice in the introduction of the no-deposit system of hire-purchase which has given a great stimulus to trade, "and may continue to do so until the class from which the customers are drawn has mortgaged to the full its prospective future earnings for the period which these contracts usually cover."¹ It may be argued that salesmanship of this kind is economically desirable in that it spurs people to further effort—to work harder and create more wealth and more purchasing power. If this were always true, the system would not

¹ W. H. Chantrey—to members of the Institute of Chartered Accountants, 1929.

be open to attack ; but observation makes it doubtful whether the stimulus operates. People demand luxuries at the expense of necessities, and by "over-spending", or living up to and beyond their incomes have no reserves on which to fall back. Hence a period of trade depression, unemployment on a considerable scale, changes of method of production through invention, may throw people who have mortgaged the future on to the resources of the community.

It is extremely difficult, if not impossible, in practice to draw a dividing line between sales which are economically desirable, and those that are harmful to the individual. In a general way it is true to say that any sale which leads a person to "over-spend" and to change his scale of demands from more productive to less productive channels is objectionable. On the other hand it must be realized that the potential purchasing power of a community is not fixed ; it is continually changing with the progress of science ; increased saving and investment abroad. More sales may consequently be desirable as a spur to economic progress. In industries which are subject to the law of increasing return, it is probable that increased sales are of great economic advantage. The more goods demanded the smaller will be the cost per unit, and the cheaper the price. Motor-cars, household requisites of all kinds, gramophones, etc., are examples of productions where increasing output brings a lowering of the costs per unit. In such cases the community benefits from improved salesmanship.

The social advantages of advertising and salesmanship are obscured in modern times when the producer educates the public in the direction of demanding certain goods or services. In former times the individual was able to make a choice between limited alternatives; to-day he requires technical skill to make a choice, and is offered alternatives covering such a wide range of quality that he is often outmatched by the technical skill of the producer. The state, therefore, has to protect the consumer where articles of consumption are in the nature of necessities, e.g. milk, bread, meat, etc.

When we turn to the problem of salesmanship abroad different problems confront us. Many foreign countries are still in an undeveloped economic state: the interiors of all the continents are still awaiting the civilizing influence of modern standards of living. The potential purchasing power of men and women in these areas is enormous, and is constantly increasing. Here we have an almost unlimited field for research in which legitimate salesmanship can benefit both the producer, the consumer, and the whole world. If every native of the tropics could be persuaded to "want" a cotton shirt, our mills in Lancashire would be occupied for many years to their full capacity. Suppose, then, that natives could be persuaded to desire the ordinary comforts of civilized life—those that are beneficial to the body and good for morals—the comforts of cleanliness and hygienic surroundings. Add to this the luxuries which are uplifting and civilizing, such as means of access to art, literature, and music,

and we see that the potential purchasing power of primitive races is capable of revolutionizing our whole industrial system for the good of humanity.

There would appear to be wider scope for development in foreign salesmanship, and it is to meet this new opportunity for industrial activity that efforts are being made at the present time. It must not be imagined that we shall have the field to ourselves. Commercial rivals are equally well aware of the possibilities of the situation. The salesman has to have accurate knowledge of the foreign market; he must be able to speak foreign languages really well; he must have skill in carrying through negotiations; he must be supplied with commercial, technical, and financial information; he must be prepared to render service to his buyer after the sale has been made. The last century saw the application of science to production; the present may see scientific marketing and selling. Courage, enterprise, and personality are qualities which the salesman in the foreign market must possess.

The Americans have sought to exploit their home market with greater skill by a better control of sales from a central sales department which has made a close study of the territory served by a producer. They fix a maximum sales limit for a particular district based upon a calculation of how much of their merchandize the population can absorb at a particular price. Lists of possible customers are made out, with the financial standing of each. Then they work the ground intensively and check their results with their

estimates. They aim at avoiding overselling, and at keeping the works going to full capacity all the time.

The English manufacturer had been content up to a few years ago to leave much of his selling abroad to an export merchant. More direct methods are called for, and manufacturers are seeking to discover their customers' requirements by visiting their markets and making inquiries on the spot.

PROBLEMS AND EXERCISES

1. What are the duties of an agent to his principal ?
2. In what cases is an agent personally liable ?
3. What is the distinction made with regard to consideration between a bill of exchange and an ordinary simple contract ?
4. What are the implied conditions in every sale, subject to an agreement to the contrary ?
5. What is a contract for the sale of goods ? In what ways may contracts for the sale of goods be made ?
6. "Manufacturers may raise their selling costs (i) by badly considered expenditure for selling in small markets, or (ii) by having too great varieties of production" (Sir Philip Cunliffe-Lister). What is called for to remedy such a state of affairs ?
7. The best salesman is not only a traveller, "but an intelligence officer who reports what is required so that manufacturers may meet and anticipate local demands." Justify from your studies the truth of this statement.
8. "Advertising, by stimulating the demand for goods, enlarges the business of production and creates the condition in which the law of increasing returns comes into effect. The more that is produced the cheaper each unit of production should be" (Sir Robert Horne). When is the above true ?

9. When does an agreement to sell become a sale? How is a sale entered into?
10. What is the legal position where a factor sells goods? What is meant by a "condition" in a contract? What is a "warranty"? Give examples. What is an "implied condition" in the case of goods sold by description, e.g. No. 1 Manitoba Wheat?
11. Why has the legal rule "caveat emptor" (let the buyer beware) been largely superseded to-day?
12. What are the three "implied conditions" of a sale by sample?
13. In the case of a sale of goods "on sale or return", when does the property pass?
14. In order to be binding what must be the characteristics of "trade usage"?
15. In the case of goods to be sent by sea, when has the seller performed his part of a c.i.f. contract?
16. What are the legal rights of an unpaid seller? What is an "unpaid seller"? What does a "lien" on goods imply?
17. What is meant by "stoppage in transitu"? Where does "transit" end? In what cases is there a right of re-sale of goods?
18. Enumerate eight of the more important methods of advertising. What are the distinctive features of advertising in a newspaper of national circulation?
19. What characteristics must all advertisements possess if they are to be effective? What things attract attention?
20. It has been said that "credit saves commercial on-costs". How does credit bring in the assistance of auxiliary commercial institutions? Why can credit reasonably be given to customers? How do we guard ourselves in giving credit? How can we measure the legitimate requirements of a customer?
21. Bearing in mind the legitimate requirements of each customer, how can we organize the giving of credit? How would a steady rise in prices affect our scheme? How can the granting of credit be checked in a large business?
22. How do the London warehouses work their credit system?
23. What is the best method of dealing with overdue accounts in a large business?

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24. Is there any reason why the seller in the warehouse, shop, or through the post, should charge all his customers the same price for the same goods? Why does he then have fixed prices?

25. How can the art of salesmanship be defined? Does a salesman require training? What must a salesman know about the goods he sells?

26. How would you deal with the orders received by a company doing a large business?

27. Sir Lynden Macassey suggests that a salesman abroad should have among other things:—

(i) Accurate knowledge of the commercial requirements of the country and its language.

(ii) The requisite personality and negotiating ability to use his personality to advantage.

Discuss each of these, and say what further requirements are necessary.

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CHAPTER XVIII

THE FUTURE OF INDUSTRY AND TRADE

New scientific discoveries and inventions are so rapidly altering the social and economic life of all nations that he would be a bold writer who attempted to forecast the trend of industry and trade during the next half century ; but in the light of the rapid changes which have occurred in the last ten years, certain lines of commercial development can safely be deduced.

(1) Rapid and effective means of communication and transport have converted the interiors of all continents to potential areas of commercial development. Whereas up to 1870 the interiors of continents were without good roads and railway systems, and in cases undiscovered, their resources have now been tapped, and new areas enter into the commerce of the world.

The Tropics, formerly regarded as fever-ridden, useless zones, are rapidly being made habitable for white men as a result of modern medical and physical science, and access is given to the control of enormous resources. Rubber, oils, and cotton now enter into a wide range of industries, and make us more dependent on tropical and sub-tropical regions for the maintenance of our manufactures. Men and women everywhere are being trained to demand new standards of living,

and their demands react on the great manufacturing countries of the world. An enormous potential demand still awaits the trader. The interiors of continents form a great potential outlet for our manufactures.

(2) The spread of education and the facilities for travel tend to level down racial and social inequalities. The barriers between nations are being broken down by common understanding. The Great War emphasized the fundamental interdependence of all the nations of the world,¹ and has shown us that our financial and commercial interests are so closely interwoven that the dislocation of another world war would ruin all the nations involved, no matter which countries were nominally victorious, owing to the destruction of world resources and the slaughter of hundreds of millions of helpless citizens of the world. It may be that the spread of this fundamental doctrine and the realization of the futility of war will tend to divert the energies of man from destructive to productive enterprises.

(3) It is probable that new scientific methods of producing raw materials and foodstuffs will assure the world of a larger supply of wealth per head, which will mean increased prosperity to all classes. A hundred years ago it was believed by many that the law of diminished returns in agricultural industries would operate henceforward, and that in consequence of this the food supply of the world would be in danger. It

¹ "The Commercial world forms an interdependent community, the prosperity of every member of which is bound up with the prosperity of the others." *Balfour Report* (Cmd. 3282, 1929).

is true that in all industries, particularly in agriculture, after a time the application of additional capital and labour will bring in a smaller return. But we know that if new ways of producing raw materials and foodstuffs were not discovered, in the long run the ground would become exhausted. But science and industry are not static ; new discoveries are being made at an increasing rate, with the result that in agriculture a greater output of food is being obtained from a given area. Wheat lands which at the beginning of the nineteenth century were only producing 12 bushels per acre, are now producing 40 bushels per acre. Farming has become a kind of factory industry, and science will continue to study its special problems. It is therefore not true to say that as a whole returns in agriculture are diminishing ; although there is, of course, a point of production after which returns will diminish. The progress of science pushes this point farther and farther off.

In manufacturing industries, as a result of scientific industrial organization, and the rationalization of industries, greater quantities of manufactured goods are being turned out at a smaller cost per unit. There is still an enormous field for improvement in this direction ; and increasing returns will continue.

(4) In view of the advantages to be obtained from mass production, it is probable that industries of the future will continue to be concentrated. The producing and distributing unit will become larger and larger. The whole of the world production of certain products will be controlled by a few international combines.

By this time democracy in all countries will probably have become so enlightened that these international combines will be democratically controlled. Such a state of economic organization would be a guarantee against future wars.

(5) Division of labour, or specialization, will continue ; both with industrial processes and with human services. Technical skill will be more and more necessary in the factory, and in the control of distributive systems ; but it will be concentrated in fewer hands. Even to-day in a modern factory employing 2,000 workers, there are probably not more than twenty who are able to use any creative ability they may possess, and not more than four or five who take the initiative either in production or distribution. In the higher ranks of industry, trade, and commercial services, the demand for people with creative ability will increase. It may be that the ranks of the highly-skilled organizers will grow smaller, though the attractions of posts may be greater. Group control may play a larger part.

(6) A simplification in methods of distribution will probably take place in the course of time, especially in foreign trade. Manufacturing companies will have international branches and depots ; the large combines may manufacture in one country and send out parts of the finished products to be assembled in factories scattered throughout the world. There is already a marked tendency for this organization of industry ; assembling factories are springing up near the chief towns in most countries.

While it is difficult to take a long view of the future of commerce and industry, we may assume with some degree of certainty that the past will throw light on the future: "We must look backward in order the better to look forward."

1. We are rapidly breaking down dogma, convention, and the dulling influence of habit. People are more responsive to new ideas.
2. Scientific discoveries have been responsible for a phenomenal revolution in all branches of industry and trade. The present standard of living of all classes is due to science.
3. Human effort of all kinds is being harnessed. It is realized more and more that the innermost recesses of the mind contain a fund of potential thought and effort which, if directed in right channels, may be productive of the greatest good. Schemes of vocational guidance and industrial psychology are among the new features of the age.

Once these influences operate everywhere, the effects of the interaction of mind on matter will transcend imagination. In the economic world of to-morrow, labour and matter will not be wasted: the resources of every part of the world will be utilized in a way undreamt of at present. Scientists will surpass the wonders of the philosopher's stone; new sources of power will enable production to be carried out at a fraction of its present cost, and in a fraction of the time now occupied in the creation of wealth. The transmission of electric power will render our present conception of factory areas a horrible nightmare of the past. Already round greater London the new type of factory is revolutionizing our ideas of productive areas,

while the present schemes for decentralizing population, and housing people in an environment not devoid of æsthetic attractions, ushers in the seemingly idealistic dream already indicated. It may be that the cheap transmission of power may take us back to an economy similar to the domestic system of the later Middle Ages, but without the evils of that period.

In transport events are moving too rapidly to predict even immediate possibilities with any degree of certainty. What is, however, certain is that time and space are apparently dwindling and the whole world is becoming one large economic unit. Economies in methods of transport will probably entirely change our methods of distribution. In the future cotton will not be transported 4,000 miles to be manufactured, and then transported back to the producing area. Many of our middlemen may disappear, and their functions, slightly transformed, be carried on by producers. The consumer, or members of the public, will still want to consume goods in small quantities, while the giant productive enterprises will still want to manufacture on a large scale.

But in all speculations of this kind we must reckon with the powerful effect of education in modifying the ideals of people. This is perhaps the most difficult sphere in which to dream visions. Half a century is infinitely small when measured against the geological conceptions of time, but it has proved long enough to revolutionize our educational outlook. It remains for the educationist of the future so to fashion the minds of generations yet unborn that they will know

how to use the leisure set free by economies of production and distribution, and to establish happy relationships without which a new economic regime is but an empty shell.

PROBLEMS AND EXERCISES

1. What forces determine the industrial and commercial future of a country?
2. How can the well-being of a community be improved? How can we test economic and æsthetic progress?
3. What are the five causes of high productive power in industry in any country? Estimate the importance of education in the development of productive power.
4. During the war our economic resources were organized by the government in the interests of all consumers and producers. Why is it harder to organize our economic resources in peace time?
5. Why was slavery abolished? Was the slave organization of society economically sound? Why is it easier to solve the problem of long distance speaking by wireless than to solve the problem of poverty?
6. Give a list of Englishmen and Englishwomen who have succeeded in establishing higher social and economic ideals, and briefly summarize the effect of their work and teaching. What is meant by saying that a person is ahead of his time?
7. On what two industries in a modern community do all the others depend? Why? What renders possible their development?
8. Summarize the causes of economic progress during the nineteenth century as outlined by Professor Keynes in *The Economic Consequences of the Peace*.
9. "The new industrial outlook will treat a nation's resources as a prudent man treats his capital, not as a spend-thrift spends his income" (Bertrand Russell). Comment carefully on the author's meaning.

10. "A community is in a good state in which there is a great deal of instinctive happiness, a prevalence of friendship and affection rather than hatred and envy, and the intellectual curiosity which leads to the advancement and diffusion of knowledge." Discuss this statement with all that it implies in business economics.

11. "To run a first-class business well the rudiments of knowledge only are required." What knowledge was ignored by the business man who made this statement? Outline ways in which such knowledge may be acquired.

12. "Energy and quick comprehension, rather than learning, are the qualities that lead to success in business life." How far is this true?

13. Give examples of acquired knowledge that can be used to advantage by the business man.

14. Why do you think it is considered unprofessional conduct for the physician and accountant to advertise, and not for the business man?

15. Give instances of government interference with the free conduct of business in recent years and proposed business legislation for the protection of particular interests.

16. How would the emigration of men and women from the United Kingdom to the colonies solve our problem of unemployment? If hundreds of thousands of our ~~best~~ artisans emigrated how would the productive power of the country be affected?

17. Give examples to show how organized science is helping to solve economic problems.

18. How may the United Kingdom maintain her industrial leadership?

19. Is it possible that English industries would survive the exhaustion of our coal supplies? For what purposes is powdered coal being used? What other sources of power does Great Britain possess?

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